

## **Executive Summary**

This paper examines the state of the Saskatchewan Cow/Calf industry and the difficulty it is currently experiencing due to low cattle prices. The paper evaluates the factors influencing the current low feeder calf prices and offers an examination as to their longevity.

The Saskatchewan cow-calf sector has endured considerable hardships in the past few years. Most notably being the BSE outbreak in 2004 that resulted in the closure of all export markets to the cattle industry. Though the borders have re-opened and cattle producers continue to explore innovative methods to market their cattle, increasing difficulties and market irregularities are eroding the viability of this extremely important industry.

With the removal of the freight rate caps in 1994 and then the Crow benefit in 1995 freight rates on grain increased from \$4.85/tonne in 1983 to \$42.00/tonne in 2007. The result of these higher freight rates has been a lower feed grain price in the prairies making it beneficial to add value to the feed grain by feeding it to cattle. A major rationale for the change in freight rate policy was to increase the value added activity in the prairies, especially in the livestock sector. During this same period the Canadian dollar depreciated against the U.S. dollar, giving Saskatchewan producers an advantage to their American counterparts.

Saskatchewan cattle producers responded to the changing market conditions by increasing the Saskatchewan cowherd to 1.5 million head, an increase of 719,000 head or 94% from the 1986 cowherd numbers. The increase in the size of the cowherd, resulted in an increase in land seeded to tame pasture with acreage increasing to 4.8 million acres in 2006: an increase of 2.7 million acres, or 123% from 1986. With the increase of area in tame pastures and native range it has reduced greenhouse gases, sequestered carbon, reduced soil erosion, improved wildlife habitat, water quality and reduced producer's dependence on government programs such as crop insurance. It also placed agriculture in a more positive environmental light through its greater contribution to mitigating greenhouse gases and the restoration of carbon to the soil.

The growth in the cattle industry that has been experienced in the last 20 years is now at risk of being lost due to recent developments. In the fall of 2007 calf prices had fallen by 26%, or \$35/ cwt, from 2005 levels (postBSE) and 36%, or \$57/cwt, from 2002 levels (preBSE). The result for a cow-calf operator with 200 cows has been a drop in revenue of \$38,500 since 2005 and \$63,000 since 2000.

The paper examines 3 market influences and the impact they have had on the Saskatchewan industry.

The first market influence examined is the exchange rate and the rapid appreciation of the Canadian dollar to the U.S. dollar. The change in the value of the Canadian dollar has lowered steer calf prices by \$12.12/cwt compared to the same period in 2007. In the last

57 years, the Canadian dollar has only been greater than the U.S. dollar 12 times. While the past is not always a reflection of the future, at this point it may be premature to assume that the exchange rate will stabilize near current levels.

The second influence on the market is the rapid rise in feed grain prices due to world demand and supply condition and the growing ethanol industry, particularly in the United States. All feed grains are currently trading at record highs, reducing the profitability in the cattle feeding sector and affecting their ability to pay a higher price for feeder cattle. This paper concludes that while higher feed grain prices could be expected in the future, normal crop production Saskatchewan should restore its feed cost advantage relative to the U.S.

The third influence on the market that was examined is the United States Country of Origin Labeling (COOL) proposal, which is to come into effect on October 1, 2008. COOL is directed at retailers, wholesalers and packers, as they are the ones responsible and accountable for implementation. Retailers will have to determine the consumer demand for differentiated product and the cost of that product. The question is, do the consumers treat that product differently? Surveys and studies suggest that they do, which if true will require retailers to segregate the product on the shelf. Retailers are typically reluctant to provide shelf space for similar goods unless warranted by volumes. If this occurs, retailers will then not place orders for that product or will only sell it as specials.

The impact on Saskatchewan producers as the result of COOL will be similar to the impact that BSE had on the markets when the basis (Oklahoma-Saskatchewan) on feeder cattle increased by \$10/cwt to \$15/cwt. There is still uncertainty as to the impact COOL will have on Saskatchewan producers as the rules have not yet been published and COOL is still dependent on the 2007 Farm bill being passed.

The result of these three market influences has been a change in the basis between U.S. feeder calf prices and Canadian feeder calf prices, from a historical basis of -\$0.71 to the current basis of \$20.71/cwt. The result of a changing basis is a loss of revenue of \$22,781 to a Saskatchewan rancher with 200 cows. Combined with a lower exchange rate that same rancher's revenue will have dropped by \$39,325 compared to 2007.

The Saskatchewan cowherd has nearly doubled since 1986 to its current level of 1.48 million cows. The growth in the cow numbers has occurred on large farms where cattle are their main income source. In 2006, 15 percent of all farms accounted for over 50 percent of the cattle numbers. With the increase concentration of the cattle herd into fewer farms, it places the industry at greater risk to a major decline, if the industry is no longer profitable.

With the increase in the cowherd has come an increase in land put into tame hay or seeded pasture. Tame or seeded pasture acreage increased 2.6 million acres by 2006, with the acreage now at 4.8 million acres compared to only 2.2 million acres in 1976. In the past, both the federal and provincial governments have provided programs to protect fragile lands. For example: Economic and Regional Development Agreements, the

National Soil Conservation Program, Permanent Cover Program (PCP), Green Cover, Green Plan, etc. The rationale for such programs has been two-fold. First, the need to protect marginal lands and the benefit they provide to the public, and secondly to reduce government program costs as the result of marginal lands being in crop protection.

Past studies have found that the conservation reserve program in the United States resulted in significant carbon sequestration and other co-benefits such as a reduction in soil erosion, and improved wildlife habitat, water quality and landscape aesthetics. A federal government study estimated that the PCP generated carbon benefits with a value of \$72 to \$362 million.

A U.S. study reported that if the CRP had been designed with carbon sequestration as an objective it would sequester 4.14 million tons on 3.9 million acres. At a carbon value of \$15/ton, the value of carbon sequestration from grassland would be approximately \$15/acre.

The federal department of agriculture has estimated that the PCP reduced other government program costs by \$9.15 per enrolled acre. This may underestimate the reduction in government expenditures in that for the last 5 years the average government expenditure on crop insurance alone was \$7.38/enrolled acre. It would also be expected that grassland converted to crop land would have a above average crop insurance cost due to the marginal nature of the land which would be expected to have more variable production.

The current low calf prices are primarily the result of a higher value Canadian dollar, rising feed grain costs and increased border regulatory costs. This has resulted in a calf price 35% lower than what it would otherwise have been. Using cost of production numbers from Manitoba, rancher will be losing \$154/cow to \$253/cow at the current 2008 prices.

With grain prices at historical highs, combined with losses in the cow-calf sector, it is expected that without policy intervention cow numbers will decline, along with a reduction in grassland acres. It is not unrealistic to expect cow numbers to decline to the mid-1980's level of 700,000 head with a potential loss in grassland of 2.0 million acres.

The loss of the cow-calf sector will have a significant impact on the feeding/finishing sector and the loss of grassland will result in significant ecological damages. As well, the conversion of grass land to cultivated land will increase both levels of government costs for programs such as Crop Insurance, and the Business Risk Management programs. As well, the increase in cultivation, depending on farming practices could result in increased CO2 emissions, and erosion and lower water quality.

The loss of grassland will erase the benefit of past government programs which spent millions of dollars to convert these fragile lands from cultivation into grassland.

What is uncertain from the analysis is whether the current market conditions are permanent and the cattle industry needs to make the necessary adjustments, or whether they are short term in nature, and market conditions will return to a more normal pattern.

With respect to the high Canadian dollar it is very unclear what the long-term direction the dollar will take. If the past were an indication of the future, one would expect the dollar to trade at a discount to the U.S. dollar.

The market has changed for the feed grains, the growing world demand and increased demand due to biofuels means that feed grains into the future will trade at a higher level. The major impact on the province isn't just the higher feed grain prices but the loss of its feed cost advantage over the U.S., as feed grains are relatively cheaper in the U.S. It is reasonable to expect that this advantage will return to Saskatchewan in the next few years.

With respect to the increase in the basis in general, and the increased costs due to BSE and COOL, policy it is difficult to predict where this will go in the future.

Given the uncertainty in the marketplace and the effort governments have put into preserving and converting fragile lands into grasslands it would be prudent for governments to put into place, policies which would prevent this detrimental conversion.

The paper proposed 5 policy options to be considered as possible solutions to halt the exodus of producers from the cow-calf sector and prevent the conversion of grassland back to cropland. These proposals are:

1. Grass Protection Payment of \$30/acre;
2. Changes to the Business Risk Management Programs;
3. Rollback of Community Pasture Rates;
4. Oppose Country of Origin Labeling; and,
5. Review of Regulatory Costs Associated with BSE.