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U.S. Farm Policy: Prospects for Crop System Diversity; Proposed Stocker Contract - CME

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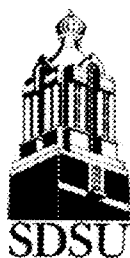


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South Dakota State University

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U.S. Farm Policy: Prospects For Crop System Diversity



by

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Less than three years after passage of the historic 1996 Federal Farm Bill (the Federal Agriculture Improvement and Reform Act), Congress and the President have passed emergency legislation to compensate for low commodity prices. There was intense partisan debate for months about the measures to include in the budget bill that was finally passed by Congress and signed by the President on October 21, 1998. Democrats generally argued for raising the ceilings on marketing loan rates. Most Republicans, on the other hand, preferred to support income by increasing the "production flexibility contract payments" farmers receive. In effect, Democrats proposed a fundamental reexamination of safety net mechanisms, while Republicans argued against "turning back the clock" to previous farm bill approaches that emphasized commodity-specific price supports.

We explained in a Commentator issue a little more than a year ago (No. 380, Oct. 17, 1997) how the 1996 Farm Bill replaced crop-specific "deficiency payments" with these "production flexibility contract payments". A key feature of this change in income support mechanisms was that farmers now have almost unlimited planting flexibility. In that Commentator issue a year ago, we posed the question "Will this flexibility result in more crop system diversity over time?" We also described how crop systems have narrowed over the last half century in seven eastern South Dakota counties. Since then, we have extensively
(Continued on p. 2)

Proposed Stocker Contract – CME

by

Gene Murra
Professor Emeritus

The Chicago Mercantile Exchange (CME) has a proposal before the Commodity Futures Trading Commission (CFTC) for a new stocker cattle futures and options contract. That contract, along with the current feeder cattle contract, will be the focus of this article.

Current Feeder Cattle Contract

The feeder cattle contract currently traded on the CME is a "yearling" contract. This is because the basic unit for the contract is a 700-800 pound feeder steer. While many aspects of the contract have remained stable since its inception, there have been some changes in recent years.

In September, 1986, the feeder cattle contract was changed from a deliverable contract to a cash settled contract. That means delivery of live animals no longer is possible. The cash settlement price was based upon a price series collected and maintained by Cattle-Fax. The contract was for high quality steers in the 600-800 pound range.

In January, 1993, the settlement price for the contract was changed to an index called the CME Composite Weighted Average Price for feeder steers. The change in 1993 included a narrowing of the weight range from 600-800 pounds to 700-800 pounds. A slightly different, regional market and weighting scheme was adopted to make the "series" more relevant to what was happening in the "real world." The settlement price is a seven-day average and is for a 50,000 pound contract.

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(U.S. Farm Policy ... cont'd from p.1)
analyzed policy and other influences on past changes. Also, we conducted focus group interviews with farmers and others in an attempt to answer the question about probable impacts of the Farm Bill's planting flexibility on crop system diversity. This issue of the Commentator contains a brief summary of insights gained from the focus group interviews.¹

Focus group interviews

We assembled four focus groups of farmers in fall 1997, two in Codington County and two in Moody County. Farmers representing different crop and livestock systems and a range of farm sizes were invited to these sessions. An average of six farmers participated in each of the four sessions. Both husbands and wives were invited, and in a few cases wives did attend and participate in the focus groups (they are included in the average of six participants). The most prevalent cropping system among Codington County participants was a corn-soybeans-wheat rotation. A few also had alfalfa in the system. One had a very diverse system that included oats, sunflowers, alfalfa, corn, soybeans, and wheat. In Moody County, the corn-soybean rotation was predominant. One farmer had a rotation of oats, alfalfa, corn, and soybeans.

Following lunch, historical data since mid-century on crop systems in the applicable county (Codington or Moody) were presented as background. Then, the following open-ended questions were asked to participants in each focus group:

1. What are the major factors that have influenced this evolution of crop systems since the early 1950s?
2. Do you think that the planting flexibility features of the 1996 Farm Bill are likely to make any significant and lasting alterations in the crop system patterns that existed in this county as of the mid-1990s?
3. Do you think that the 1996 Farm Bill's combination of decoupled support payments and relatively low loan rates is likely to cause farmers in this area to change their risk management strategies, including mix of crops grown

and use of multiple peril crop insurance (MPCI) and crop revenue coverage?

4. Do you think that concerns about soil erosion, water quality, and other environmental matters are likely to cause changes in the mix of crops grown in this area over the next 10 years? Also, do you think that USDA environmental programs are likely to have much impact on the mix of crops grown.

We also conducted one focus group meeting with several research and extension faculty members in the SDSU Plant Science Department. This meeting focused primarily on technology and management considerations in crop system selection.

Prospects for future crop system diversity

At the time focus group meetings were held in fall 1997, two crop years had been completed under the 1996 Farm Bill. Corn acreage in South Dakota was up 14 percent in 1996 and 9 percent in 1997 over the 1991-95 average. Soybean acreage was up (compared to the 1991-95 average) much more, by 19 percent in 1996 and 54 percent in 1997. Statewide wheat acreage was 19 percent over the 1991-95 average in 1996. However, wheat acreage was down in 1997, to only 15 percent above the 1991-95 average. By 1997, statewide oats acreage was 42 percent below the 1991-95 average and barley acreage was down 61 percent. Flax acreage was down 33 percent, to only 15,000 acres, by 1997. Thus, the statewide picture after two years of the new farm program was tremendous growth in soybeans and some growth in corn and wheat acreage. Crops like barley, oats, and flax experienced decreases in acreage.

Many things, such as weather and relative prices, influence changes in acreage over just a couple of years. Therefore, our focus group interviews had a longer-term perspective. The general consensus of focus groups in both Codington and Moody Counties was that there would be a move toward more corn and soybeans, due to the usual relative profitability of these crops. In cases where base acre provisions of previous farm bills kept some Moody County farmers from a 50-50 corn-soybeans rotation, those farmers are now moving to 50-50 rotations. The expense of equipment is inducing many farmers to grow just

¹ More detailed findings from the focus group interviews and other analyses included in this study will be available in a soon to be completed Master of Science thesis by Linda Dumke.

corn and soybeans; the more narrow the rotation, the less equipment is needed.

In Codington County, farmers indicated that there could be more year-to-year fluctuations in crops planted due to the "decoupling" of payments. Disease and pest problems also may have more influence on planting decisions, now that there are no base acre provisions. Some farmers indicated that they might plant more small grains, in part due to the cyst nematode problem in soybeans and in part to cut down on weeds. However, some Codington County farmers mentioned that *Fusarium* head blight (scab) in wheat may cause a switch to strictly corn and soybeans, if acceptable resistant varieties of wheat can not be found.

Farmers and plant scientists felt that the main reasons alfalfa is not included in more crop rotations are (a) the expense that would be required for additional equipment and (b) the time it takes to put up alfalfa. The window of time to put up alfalfa can be very limited at times. Farmers are at the mercy of the weather; there is a need for options to allow for hay to be put up under wetter conditions. Storage and handling of alfalfa also are concerns of farmers. Until recently, crop insurance was not available for alfalfa hay. Policies that are now available have a number of restrictions. Furthermore, marketing hay can be time-consuming, and some farmers are concerned that the high hay prices of recent years may not continue.

Farmers and plant scientists noted that agricultural chemicals have made it easy to deal with just a few crops, such as corn and soybeans. Labor availability is another factor keeping farmers in fairly narrow crop rotations. The increasing number of activities available to youth interfere with farm teenagers devoting as much time to farm operations as was devoted by previous generations.

Focus group farmers felt that the current, more market-oriented farm bill is causing farmers to pay more attention to a variety of risk management tools. These include crop insurance, revenue insurance, and various forward contracting and futures market tools. However, there was a feeling that these tools are not yet inclusive enough to encourage more diverse crop systems, particularly systems that include crops like alfalfa hay.

Codington and Moody County farmers generally felt that environmental programs probably

would not have much impact on the mix of crops grown. Such programs influence decisions about use of filter strips, chemicals, and tillage practices. Recent programs like the Integrated Crop Management (ICM) program and the Water Quality Incentive Program (WQIP) had options that supposedly encouraged more crop system diversity. However, focus group farmers saw little impact on crop mix of those programs, and foresee few crop system changes as a result of new programs like the Environmental Quality Incentive Program (EQIP).

Conclusions

Farmers in eastern South Dakota are making some changes as a result of flexibility provisions in the 1996 Farm Bill. However, changes so far and changes farmers currently envision mostly involve product mix and will not necessarily lead to more crop system diversity. Farm program acreage flexibility may be a necessary condition for crop system diversity, but it is not a sufficient condition. In addition to farm policy, several factors are exerting powerful influences on crop system decisions. These include markets, changes in technology, and changes in the structure of agriculture. If, as a State or Nation, we are serious about encouraging crop systems with greater diversity than presently exist, policies and programs addressing all of these factors will be necessary.

(Stocker Contract Cont'd from p.1) Stocker Cattle Contract

The stocker cattle contract before the CFTC is a new contract. It is not intended to take the place of the feeder cattle contract. Rather, it will supplement that contract. The new contract could be approved late in November. If approved then, the CME would start trading the January, February and March contracts in late November.

Some of the provisions of the feeder cattle contract, such as price increments, position limits, last trading day and delivery method (cash settled), have been included in the stocker contract. However, there are some major differences.

First, the proposed stocker contract's basic unit is 500-599 pound high quality steers. This is much lighter than the 700-800 pound basic unit in the feeder cattle contract.

Second, the contract unit for the stocker contract is 25,000 pounds. This is half the 50,000 pound unit for the feeder cattle contract.

Third, the trading months are those most often associated with the movement of Spring-born calves. Contracts will be offered (if approved) for the Fall months of Octob, November and December and the Winter months of January, February and March. Contracts will not be offered, at least not initially, for April, May, August and September. Contracts for those months will continue to be offered for the feeder cattle contract. (Note: The feeder cattle contract currently traded does not have a Feb or Dec contract.)

The contract will be cash settle on a seven-day weighted average of USDA prices. The market area will be a 12-state region of states in the central part of the U.S. South Dakota is one of those states.

Impact of Stocker Contract on Area Producers

The four major changes in the stocker contract from the feeder cattle contract should have a positive impact on South Dakota and area farmers and ranchers. The stocker contract should be "easier" to use and have less basis risk.

The proposed weight category of 500-599 pounds represents what many producers sell. It no longer will be necessary to adjust for major weight differences (remember the feeder cattle contract basic unit is a 700-800 pound animal). This should make the futures prices quoted more meaningful and should reduce basis risks.

The proposed contract size of 25,000 pounds also is important. It will take about 40-50 head of 500-599 pound steers to "make up" a contract. This makes the contract "easier to use" by small-scale producers. It takes about

60-70 head of 700-800 pound steers to "make up" a feeder cattle contract.

The contract months for the stocker contract fit the movement pattern of Spring-born calves. This should enable producers to match their actual marketing with their hedging activities.

The cash settlement price series is also relevant to area producers. Calves sold in South Dakota are similar (some say better) to calves marketed in the "price basis" area and the state's markets are as close as any to the nation's major cattle feeding areas.

Conclusion

The proposed stocker contract should be a good one for the state's cow-calf industry. It closely represents the production patterns (animal size, contract amount and sale dates) of many cattle producers in the state and region. Even if producers do not trade the contract, it should provide better price information.

The CME probably will conduct meetings to inform producers and others about the new contract. Those meetings likely will be held after March, 1999. A meeting will be held in South Dakota likely in late May in central South Dakota and others will be held in nearby states. Watch for announcements of those meetings so you can attend to learn more about the stocker contract and futures and options in general.

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