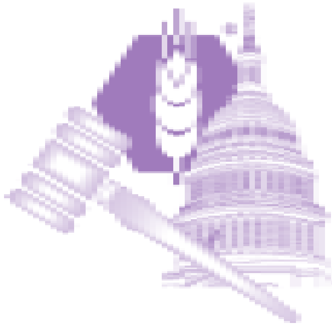

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# NGFA Provides Input to Congress on Climate Change Legislation

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*[**Editor's Note:** This publication keeps you – as a stakeholder in the NGFA – informed about issues being addressed and actions being taken to serve your business interests.* NGFA members are encouraged to contact the NGFA office to provide input, ask questions and raise other topics you believe should be addressed by your Association.]

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The NGFA has urged Congress to take an international approach and avoid incentivizing producers to take cropland out of production when considering climate-change legislation.

In a statement submitted April 10 to Congress in response to an invitation from House Agriculture Committee Chairman Rep. Collin Peterson, D-Minn., the NGFA cautioned that a unilateral U.S. cap-and-trade approach to reduce carbon emissions could create serious adverse impacts on the competitiveness of American agriculture while giving "fierce" foreign competitors not subject to carbon-emission limits a significant economic advantage.

"The problems of climate change are global in nature, and we believe U.S. support toward a global solution has the best chance to lead to a successful outcome…while maintaining the competitiveness of U.S. agriculture – an industry that consistently has contributed a positive balance of trade for the U.S. economy," wrote NGFA President Kendell W. Keith. "…Any move to reduce carbon emissions must not inadvertently incentivize U.S. farmers to take land out of production or allow carbon emitters to purchase cropland and take it out of production to earn offsets."

The NGFA urged that an assessment of carbon trading involving cropland or rangeland also analyze the adverse economic impact that such land-idling schemes would have on U.S. agriculture's competitiveness and the livelihood of rural communities. Noting that the Conservation Reserve Program already has idled more than 34 million acres, the NGFA said it would strongly oppose any legislation that provides incentives that further erode available acreage for food, feed and fuel crops.

"Further idling of productive resources not only harms U.S. agricultural competitiveness and rural communities, but also can be a particular burden on young farmers and ranchers trying to build an economically sized operation…and find it difficult to compete with government programs that provide economic incentives to idle land rather than rent or sell those acres," the NGFA said. "Such a program inadvertently could turn into a lucrative retirement program for both landowners and fertile productive farmland needed to feed the world. We want to make sure that the design of any (cap-and-trade) program will not allow for, nor encourage, large coal-fired power generators and other carbon emitters to buy large tracts of farm acreage, taking it out of production, and then converting it to rangeland and using the credits so they continue to emit greenhouse gases."

The NGFA said that grain elevators and feed mills likely would not reach the carbon-emission levels currently being considered by Congress that would trigger coverage under a carbon-reduction program. These sectors should be expressly excluded from coverage or be eligible to earn carbon credits under the legislation, the NGFA argued.

But that doesn't mean such sectors would not be adversely affected. The NGFA stressed that the grain, feed and feed ingredient manufacturing, grain processing, biofuels and grain exporting sectors are significant users of energy and already are incurring increasing electricity and transportation costs to run operations and ship commodities and products to domestic and international markets. A recent study by Oklahoma State University found that electricity costs for grain handlers have increased 19 percent over the last five

years, a trend that is expected to continue. These agricultural businesses also have incurred dramatic cost increases as a result of financing and market volatility, the NGFA noted, which can negatively affect farm prices and exacerbate concentration in agribusiness as firms become uncompetitive.

"Major (energy) cost increases undoubtedly will hit grains, oilseed, feed and biofuels companies very hard," the NGFA said, particularly because of the geographical expanse that most commodity and agricultural product shipments must traverse. "Those transportation cost increases inevitably would be passed back to producers through lower farmgate prices," the NGFA noted, given the limited ability to pass those costs forward in a highly competitive global market.

The NGFA's statement emphasized that any approach to climate change needs to be cost-effective, maintain the competitiveness of U.S. industry, be predictable, allow for sufficient transitioning, offer identifiable and measurable benefits and be conducted in concert with similar efforts by key foreign-country competitors.

"Given the magnitude and complexity of the climate-change issue, we support a deliberate, conscientious effort by Congress to carefully scrutinize a carbon-reduction program's impact on both the domestic and global grain-, food-, feed- and biofuels-production industries, as well as the resulting impact on consumers and recipients of humanitarian food assistance," the NGFA said. "Whatever the makeup of the final approach (to address carbon emissions), it must not negate the competitive advantages in technology, transportation and infrastructure enjoyed by U.S. agriculture."

The NGFA concluded by urging that the United States play a leadership role in a global effort on carbon-emissions reductions, rather than taking a "unilateral approach that may have a limited overall impact in reducing such emissions and trigger innumerable damaging, unintended consequences."

# NGFA Submits Views to CFTC on Futures Market Convergence

The NGFA on April 15 submitted a statement to the Commodity Futures Trading Commission (CFTC) outlining its views on problems with convergence in the CME Group's wheat futures contract in preparation for the upcoming deliberations of the agency's new Subcommittee on Convergence established under the auspices of the CFTC Agricultural Advisory Committee. *[See related article in April 23 **NGFA Newsletter**, page 3.]*

The statement was submitted in response to questions posed by the CFTC's staff to individuals invited or nominated to serve on the new subcommittee, which is expected to begin work soon. The agency's questions and the NGFA's responses, in their entirety, are reported below:

**1. In your opinion, which agricultural commodity (or commodities) has experienced the most pronounced convergence problem and why?**

**NGFA Response:** Clearly, the CBOT wheat contract has experienced the most marked deterioration in convergence over the past two to three years. Basis levels have been volatile and have widened to levels not expected relative to historical cash/futures relationships. Last summer's dramatic futures price advances placed severe financial stress on commercial grain hedgers and their lenders – a situation that, if repeated in this year's credit environment, would appear to be untenable. Today, even though futures prices have moved back to lower levels, basis remains very wide in comparison to what might be considered "normal." The disconnect between cash and futures has made it very difficult for commercial grain hedgers to efficiently manage their hedge positions and has called into question the utility of the contract.

We believe there are a number of reasons for the CBOT wheat contract's deteriorated convergence, including: strong commodity demand growth from emerging markets and from the biofuels industry; higher transportation and fuel costs; and very large soft red wheat stocks fueled, in part, by what we believe to be artificial futures-price signals. Soft red wheat production rose from 352 million bushels in 2007 to 614 million bushels in 2008, a 74 percent increase.

However, we believe strongly that an influx of investment capital into agricultural commodity futures markets also has had a significant impact on futures price levels. When "Index" participants in the CFTC Commitments of Traders report hold 50 to 60 percent of open interest (excluding spread trades), as they still do today – and when total open interest is more than twice the total U.S. soft red wheat crop – we believe it is difficult to deny that investment capital has a futures price impact that has contributed to the cash/futures disconnect.

**2. What are possible remedies to the convergence problem(s) that you identified in Question 1?**

**NGFA Response:** The CME Group has instituted several changes to the CBOT wheat futures contract that go into effect in July, including adding new delivery locations and moving to a seasonal storage rate. We are hopeful these changes will contribute to enhanced performance. However, we are not convinced these changes alone will be sufficient to achieve consistently an acceptable level of convergence.

The NGFA proposed in November 2008 that the CME Group consider adding a modified compelled loadout component to the wheat contract to re-establish convergence (the NGFA's letter transmitting the proposal to the CME Group is attached). After careful analysis and evaluation, the NGFA suggested modified compelled loadout as a balanced approach that could help re-

establish a more predictable relationship between cash and futures, while not unduly disadvantaging either longs or shorts.

A second contract modification that we believe deserves additional consideration is a variable storage rate concept released by the CME Group in mid-November 2008. The concept probably did not receive sufficient attention at that time, and we believe it now deserves a more thorough review as a possible contract enhancement that could be implemented quickly if the currently approved changes do not have the desired effect.

A longer-term solution may be the development of a new cash-settled index contract or contracts. The notion of a world wheat contract or an all-classes U.S. wheat contract has been discussed and seems to hold some promise. Such index contracts could be attractive to investment capital that wants to own wheat, while taking upward futures price pressure off the traditional contract and helping re-establish its hedging efficiency. We are aware that the CME Group has done some analysis of the index contract concept, but it is probably a longer-term solution that will not yield the near-term improvements in performance needed by traditional hedgers.

**3. What are the pros and cons of adopting the remedies that you suggested in Question 2, and for whom?**

**NGFA Response:** The NGFA believes the primary advantage of its modified compelled loadout proposal is that it would achieve the convergence needed by traditional hedgers, for whom the contract originally was intended to provide price discovery and risk-management functions, relatively quickly. By exposing non-traditional participants to the potential for taking physical delivery of wheat, we believe modified compelled loadout would help modify behavior of investment capital in the wheat futures contract in such a way that cash and futures quickly would re-establish a meaningful and predictable relationship.

There are those who believe the NGFA's modified compelled loadout proposal would bring too dramatic a change to the contract, including concerns about transportation and introducing some additional volatility in futures spreads. However, we believe the modifications developed as part of this proposal help address those concerns and, most importantly, maintain balance between longs and shorts in the marketplace without disadvantaging either.

As mentioned previously, we believe the CME Group's variable storage rate concept also could enhance performance of the wheat contract. It has the potential, layered on top of the pending seasonal storage rate change, to respond quickly in raising or lowering storage rates which should, in theory, enhance convergence. It also has the advantage of being a relatively straightforward change that could be introduced quickly if the pending seasonal storage rate and delivery location changes do not have their desired effect – an important factor for our member companies, which have been attempting to cope with the contract's lack of convergence for the last two years.

Consistent with the NGFA's feedback on this concept last December, we advocate that the CME Group provide additional education and examples if the variable storage rate concept was adopted. This could help overcome any reservations about the concept's complexity, any effects on liquidity, or concerns that more sophisticated participants with greater information access could gain a market advantage. There also would need to be discussion about the optimal trigger level for storage rate increases or decreases, and the size of storage rate increases, to effectively promote convergence.

Finally, we can see advantages to a cash-settled index contract – traded side-by-side with the existing contract – in that it could be attractive to investment capital and help ease artificially inflated futures price levels, thereby helping to re-establish a predictable and consistent cash/futures relationship in the traditional contract. Properly structured, an index could also better reflect true cash values in various geographic areas.

Some challenges also are evident in development of an index contract or contracts. It could potentially be complex and difficult to administer. We also have heard concerns about how accurate cash bids would be collected and reported. While we believe the index concept holds promise, it seems clear that careful product development is needed.

# NGFA Advises FDA on Draft Guidance on Importer Practices

The NGFA has urged the U.S. Food and Drug Administration (FDA) to revise its initial draft of an industry guidance document on good importer practices to incorporate the same science-based risk-assessment and risk-management principles embodied in the agency's 2007 Food Protection and Import Safety Plans.

In a statement submitted to the agency on April 15, the NGFA said it was "troubled" about the absence of a risk-based approach in portions of the draft guidance document in which FDA suggests controlling, monitoring and verifying the compliance of all foreign products and foreign producers prior to arrival of agricultural, food or feed ingredient products into the United States, as well as knowing the preventive controls implemented by each foreign firm "at each critical point" in the product's life cycle. Nor does FDA's draft guidance suggest using a risk-based approach when encouraging importers to conduct paper audits of foreign suppliers' production and processing records, or when recommending importers purchase only from "certified" foreign firms.

"Failure to recognize a risk-based approach is a significant shortcoming, and could subject many U.S. importers to increased costs of doing business with little commensurate offsetting benefits

in terms of product safety and protection of U.S. consumers," the NGFA wrote.

The NGFA also told FDA it was inappropriate and premature for the agency to include in industry guidance a recommendation that U.S. firms purchase only from "certified firms," since the agency still is seeking legislative authority and has not yet established a formal certification-accreditation scheme.

The NGFA also encouraged FDA to continue with its "cautious, measured, collaborative, and science- and risk-based approach" in developing food-safety strategies for imported products to avert potential trade retaliation against U.S. agricultural exports. "It is important that FDA be cognizant of potential significant trade disruptions and retaliation that may result if the U.S. government adopts requirements or imposes conditions on imported products that are not science- or risk-based, undermine a foreign country's sovereignty, or which the United States would not want imposed on U.S. firms by foreign countries or trading partners.

Concerning other aspects of FDA's draft guidance for importer practices, the NGFA:

- urged the agency to include more references to the important role and function played by brokers in transactions between foreign suppliers and U.S. buyers. Specifically, the NGFA encouraged the agency to reference a definition of brokers, such as found in the NGFA Trade Rules, which makes clear that brokers' responsibilities are fulfilled once they negotiate or facilitate the execution of a contract in accordance with instructions from the buyer and seller, and the customs governing such transactions. The NGFA noted that in several recent adulteration incidents involving foreign products, the U.S. buyer had assumed brokers were liable for ensuring product safety.

- recommended that FDA add language to the draft guidance encouraging U.S. importers to include in contracts with foreign buyers product-specification requirements that are appropriate to safe use.

- recommended including language in the draft guidance encouraging U.S. importers to alert relevant federal agencies if they become aware of product contamination that endangers human or animal health.

- recommended including a reference to current good manufacturing practices (CGMPs) as an FDA-recognized form of preventive controls for product safety, instead of referencing only a hazard analysis and critical control point (HACCP) approach.

- recommended amending language in the draft guidance that implies importers could guarantee that product-safety incidents involving imported products would not recur. The NGFA urged FDA instead to use language encouraging importers to take steps "to protect against the recurrence of compliance and product-safety problems" that may be associated with certain imported products.

# NGFA, NAEGA Cite Shortcomings in GIPSA Report on Official Grain Inspection by Independent Third Parties

The NGFA and North American Export Grain Association (NAEGA) on April 16 submitted a statement to the U.S. Department of Agriculture (USDA) citing numerous shortcomings in a recent study by the Grain Inspection, Packers and Stockyards Administration (GIPSA) that purports to show that using independent third-party contractors to perform official inspections of U.S. grain is not cost effective.

When enacting legislation in 2005 reauthorizing the U.S. grain standards, Congress encouraged GIPSA to utilize its existing authority to authorize the use of independent third-party inspectors under 100 percent federal oversight to improve the efficiency and competitiveness of official inspections of U.S. export grain.

The NGFA and NAEGA noted that GIPSA's study analyzes only U.S. export ports that represent 20 percent or less of total U.S. grain export volume. Costs naturally would be expected to be higher at lower-volume ports, the NGFA and NAEGA noted. But GIPSA's study failed to evaluate the use of independent third-party contractors at high-volume grain export ports, such as New Orleans and the Texas Gulf, where economies of- scale associated with larger export movements could be analyzed.

In addition, the economic consulting firm hired by GIPSA to conduct the study – paid for mostly through industry user fees – did not contact **any** commercial vendors, industry or other parties outside the agency when conducting the study, the NGFA and NAEGA said. Further, the conclusions of the study frequently were not supported by the analyses presented.

"We continue to believe that the use of independent third parties operating under USDA oversight holds great promise for maintaining and enhancing the competitive position of U.S. grain and oilseed exports, while at the same time retaining the integrity of U.S. grain inspection results," the NGFA and NAEGA told the agency. "As a result, we strongly urge that industry and government jointly decide on a more cost-effective approach to change the current situation."