



## CANADIAN CATTLEMEN'S ASSOCIATION

#310, 6715 - 8th Street N.E.  
Calgary, Alberta T2E 7H7  
Tel: (403) 275-8558  
Fax: (403) 274-5686

1403, 150 Metcalfe Street  
Ottawa, Ontario K2P 1P1  
Tel: (613) 233-9375  
Fax: (613) 233-2860

### **Why is there a need for a national basis guarantee?**

There is an expectation that it will be at least three to six months and possibly longer until the U.S. border reopens for live slaughter cattle. As well, there exists the additional risk that boneless beef exports from cattle under thirty months (UTM) could be interrupted by an expanded court injunction which would cause a major market upheaval. This possibility adds to the risk that every cattle producer is facing with its current inventory on feed, and particularly on cattle that would be set aside beyond late July when the Montana court is expected to rule on the case. A national fed cattle basis guarantee is necessary to provide stability to the fed and feeder cattle markets.

In a normal integrated North American market for cattle and beef, there is a price difference (basis) between markets in Canada and the U.S. Historically, this price difference has been in the range of \$4-\$8/cwt.

With a basis guarantee, it provides another marketing option for cattle feeders: they can market their cattle or put the cattle on the program. Without the basis guarantee, producers are faced with tremendous uncertainty as to the eventual value of their cattle if they are set-aside for 90 days.

*A guaranteed basis is not a guaranteed price.* Producers do not know the U.S. market 90 days in the future nor do they know the Canadian exchange rate. A basis guarantee simply decreases the risk for cattle feeders by removing one of the pricing unknowns.

Therefore, there is a difference across provinces in the level of risk that cattle producers face in setting aside cattle without a national basis guarantee. Cattle feeders in Alberta have the choice to market or set-aside cattle, knowing the maximum basis they will be facing. Producers in other provinces do not have this ability to manage their risk.

The guaranteed basis does not remove the incentive for cattle feeders to seek the highest price for their cattle. Cattle feeders only qualify for the basis guarantee on the animals in the set-aside, not their entire inventory.

Initially, the basis guarantee was proposed to serve as a target. If the basis narrows, the Set-Aside Management Committee has the ability to release cattle. If the basis widens, and a basis guarantee is offered, cattle feeders will put more cattle in the program, shorting the slaughter market and raising the price. In a sense, the set-aside will be market driven.

*The ability to ensure the basis guarantee is not needed can be controlled by the Federal & Provincial Set-Aside Management Committees. By managing the volumes of cattle in the program, it will maintain competitive bidding for the cattle and the basis will be kept at an acceptable level.*

**Discussion Paper: National Basis Guarantee Under the Fed Cattle Set  
Aside Program**  
*Prepared by Alberta Agriculture Food and Rural Development*  
*April 28, 2005*

**BACKGROUND:**

Government set-aside programs for market ready cattle and 2004 calves were announced on September 10, 2004 to address processing capacity concerns by re-balancing supplies with projected slaughter capacity increases in 2005. The Canada-Alberta Fed Cattle Set-Aside Program (CAFCSAP) provides assistance towards the feed costs associated with holding animals for the 13 week set aside period. Cattle are enrolled into the program based on a bidding system in which the low bid is accepted until the target number of cattle is reached. A National Management Committee manages this process.

In Alberta this program also includes a component that guarantees Alberta producers a specified basis when cattle are released from the program. Under the program, basis is the difference between the mid west US market price and the Alberta price. The advantage of the basis component is the leverage it gives cattle feeders when pricing all of their cattle. The Set-Aside program is in effect a “temporary” alternative to accepting the spot price being offered by packers.

An Advisory Committee from the Alberta industry was struck to provide expert knowledge about market behaviors to an Alberta Management Committee of AAFRD staff. Alberta’s Management Committee seeks the advice of this select group before each of the auctions held under the program. The information provided by the Advisory Committee is an important part of the Management Committee’s decision-making process, particularly for the basis guarantee component.

In essence basis is the difference between the weekly price of fed cattle in key U.S. markets and the cost to get the cattle there (such as transportation, grading, other expenses) for a point in time. Basis widens (increases) and narrows (decreases) seasonally and as local supply and demand conditions change. Historically the average basis in Alberta prior to BSE was about 7 to 8 cents per pound, or Alberta cattle traded at a 7 to 8 cents discount to the U.S. price.

**Impact of the Alberta Basis:**

In 2004 the average cash spread to the reference US market was about 31 cents per pound, ranging from a low of 17 cents per pound to over 50 cents per pound. The basis component offered under the CAFCSAP has ranged from 25 cents in October 2004 to 18 cents in January and February 2005. The current basis guarantee in Alberta is 22 cents (see Table 1). Risk, as measured by the coefficient of variation on the cash market spread has fallen from 40% in 2004 to about 20% for the first 28 weeks of the CAFCSAP.

Alberta, and Ontario have so far contributed the largest share of animals to the program, Saskatchewan, Manitoba and Quebec have also set aside animals. In an environment of seasonally lower cattle prices (likely through the end of the summer period) it is difficult to comprehend why feedlot operators would want to hold cattle off the market for the

potentially lower payment into the future, even with a feed subsidy. The risk should be a sufficient deterrent to all provinces without a basis guarantee.

In Alberta, the basis guarantee:

- Allows producers to manage their price risk on set aside animals, which provides them (and their bankers) some security for these animals. At the same time, this risk is not included in the daily feed cost that producers bid to get into the program.
- Decreases the cost of the set aside program to governments as the risk that would be bid into a program with no basis guarantee would have to be paid regardless of the price/basis when animals come off of set aside. The basis guarantee only pays when the basis coming out is wider than the guarantee for the animals when they went in.
  - In general industry suggests that without the basis guarantee in Alberta, feed bids would be about \$2-5/day higher than they are right now to cover the risk of holding animals off the market. This is equal to about \$180 to \$450 per head. Based on the first fourteen weeks of cattle release from the program, Alberta has paid an average of \$60.25/head on the basis guarantee. Alberta the basis guarantee has been paid on eight weeks to date.
- Although the program is designed to help balance supplies by targeting feedlot operators that finish steers and heifers, there has been a substantial trickle down effect for the feeder cattle market.
  - Industry suggests that feeder cattle prices are about \$20/cwt higher as a result of the basis guarantee in Alberta. While this evidence may be difficult to substantiate, the confidence/security that margin operators have in their ability to manage risk through the program allows them to leverage their feeder cattle purchases. The volumes of cattle on feed in Alberta have increased substantially compared to a year ago.
- As with all assistance programs there is concern that the benefit of the assistance will simply be lost as the market adjusts and equalizes out the payment. With a basis guarantee, there is less transparency with the full benefit until the animals are released from set aside. It is more difficult for packers to capitalize on the basis guarantee payment when there is uncertainty on the magnitude of the payment until 91 days forward.

A national basis, with a level playing field (i.e. verifiable “market-ready” weights across the country) would provide similar benefits to producers in participating provinces and would make the current set aside program much more effective as a market balance tool.

## Appendix

**Table 1 Alberta Fed Cattle Basis Guarantee (\$ per hundredweight)**

Set-Aside Date	Weekly U.S. Price (Canadian \$)	Weekly Alberta Price	Release Date	Basis Guarantee	Basis Payment
October 13, 2004	\$107.46	\$79.01	January 12, 2005*	-\$25.00	
October 20, 2004	\$107.27	\$81.18	January 19, 2005	-\$25.00	
October 27, 2004	\$103.66	\$81.28	January 26, 2005	-\$25.00	\$2.0
November 3, 2004	\$99.05	\$75.99	February 2, 2005	-\$25.00	
November 10, 2004	\$100.71	\$78.28	February 9, 2005	-\$22.00	
November 17, 2004	\$101.35	\$80.32	February 16, 2005	-\$22.00	
November 24, 2004	\$104.46	\$83.24	February 23, 2005	-\$22.00	\$2.6
December 1, 2004	\$106.80	\$85.62	March 2, 2005	-\$22.00	\$11.0
December 8, 2004	\$102.91	\$83.51	March 9, 2005	-\$22.00	\$5.4
December 15, 2004	\$105.22	\$82.76	March 16, 2005	-\$22.00	\$4.0
December 22, 2004	\$110.55	\$87.32	March 23, 2005	-\$20.00	\$7.4
December 29, 2004	\$105.76	\$87.51	- No auction was held -		
January 5, 2005	\$108.04	\$85.03	April 6, 2005	-\$20.00	\$15.0
January 12, 2005	\$110.99	\$84.28	<b>April 13, 2005</b>	<b>-\$18.00</b>	\$20.1
January 19, 2005	\$109.64	\$86.71	April 20, 2005	-\$18.00	
January 26, 2005	\$109.13	\$85.48	April 27, 2005	-\$18.00	
February 2, 2005	\$111.94	\$84.89	May 4, 2005	-\$18.00	
February 9, 2005	\$111.65	\$87.64	May 11, 2005	-\$18.00	
February 16, 2005	\$108.13	\$91.95	May 18, 2005	-\$18.00	
February 23, 2005	\$107.19	\$90.75	May 25, 2005	-\$18.00	
March 2, 2005	\$111.27	\$86.66	- No auction was held -		
March 9, 2005	\$112.68	\$79.73	June 8, 2005	-\$20.00	
March 16, 2005	\$108.64	\$81.26	June 15, 2005	-\$22.00	
March 23, 2005	\$109.42	\$83.38	June 22, 2005	-\$22.00	
March 30, 2005	\$112.45	\$85.05	June 29, 2005	-\$22.00	
April 6, 2005	\$110.14	\$83.17	July 6, 2005	-\$22.00	
April 13, 2005	\$113.97	\$78.93	July 13, 2005	-\$22.00	
<b>April 20, 2005</b>	<b>\$116.41</b>	<b>\$78.31</b>	July 20, 2005	-\$22.00	
April 27, 2005			July 27, 2005	-\$22.00	

\* On April 20, 2005 the cash spread on fed cattle marketed was 38 cents per pound under the US market. Applying the 1-week lag to this data an estimated payment of 20 cents per pound (38 cents less the 18 cent guarantee) would be made on the weight of eligible animals released from the Set Aside program in addition to the tendered daily feed cost.