

*Eighteenth
Annual
Aldrich C.
Bloomquist
Lectureship*

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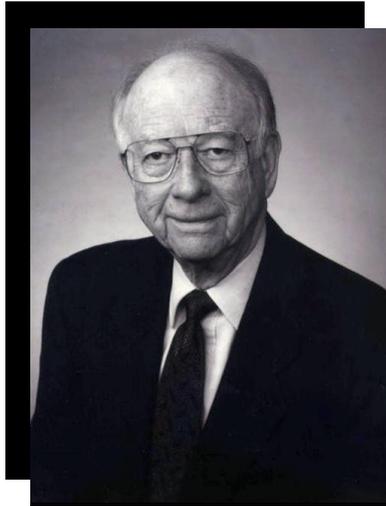
*Searching For
Leadership in a
Post-Crisis Malaise*

An address by Robert Engel
CEO of CoBank.

*7:00 a.m., Wednesday, March 31, 2010
Sterling & Crowne Room, Holiday Inn,
Fargo, ND*

NDSD

*This lectureship series
is sponsored by the
Quentin N. Burdick
Center for Cooperatives
with funding from the
Aldrich C. Bloomquist
Endowment,
established through
a contribution from
American Crystal Co.,
Moorhead, Minnesota*



This lectureship series was created to honor Al Bloomquist, who served as president and longtime executive of American Crystal Sugar. A driving force in the development and success of the Red River Valley's farmer-owned cooperative sugar industry, he became the first executive secretary of the Red River Valley's Sugarbeet Growers Association in 1961. When American Crystal was acquired by the growers' association in 1972, he became a part of the new cooperative corporation. He received an honorary degree from NDSU in 1992. In recognition of his contributions to the company and the industry, American Crystal has established this lectureship series through the Burdick Center for Cooperatives at NDSU. American Crystal Sugar is a cooperative that produces 16 percent of the country's sugar. The company is owned by approximately 2,900 shareholders and employs 2,000 men and women in the states of Minnesota and North Dakota. The company generates approximately \$1 billion in sugar sales annually.



Bob Engel, president and CEO of CoBank, is responsible for implementing the bank's strategic, business and financial plans as set by the bank's Board of Directors. Engel will discuss the need for leadership in the private and public sectors as the country emerges from the financial crisis and heads toward a recovery that won't always feel like recovery. The void in leadership that continues to plague the United States is in contrast to the values and expectations of those grounded in the cooperative form of governance and rural America.

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Lectureship

Bob Engel
March 31, 2010

Good morning everyone. Before I begin I really wanted to thank the Burdick Center for Cooperatives and the advisory board for providing me with the invitation to speak to you. I am certainly proud to be a part of the heritage of the Bloomquist Series. I want to also specifically thank CoBank's board chairman Everett Dobrinski. Everett certainly has made significant contributions over a long period of time in a variety of cooperative industries and I would tell you at CoBank we certainly share and are inspired by his passion for cooperatives. The Center and its staff now have been working for almost 20 years to promote knowledge and understanding about cooperatives through this region of the country and increasingly across the country. The cooperative model is such an important part of both the rural community and our collective heritage. Having the pleasure last night of attending the Advisory Board meeting I can tell you that the advisory board is very passionate about what they are doing here and what they are trying to accomplish. As we will talk about as I move through here is that the cooperative model has certainly proved to be a more durable and a more dependable model quite frankly than most of the ownership models that have been tried elsewhere. Greg and his team certainly do a great job not only through the coursework that they offer through the leaders at NDSU but also through the research, training and their public outreach programs.

As Greg mentioned, I am here a year later than expected to be owing to the floods that washed out last year. I am certainly glad that the floods didn't come again this year. I thought that you would never invite me again. We are certainly thankful there wasn't a repeat occurrence of that magnitude. When the opportunity arose again for me to come this year I thought about just taking the presentation I had prepared last year. As I thought about that, I realized we know more than we knew a year ago. We really came off the edge of a financial cliff that we were on a year ago in March of

2009 and certainly if you moved back six months from there to December 2008. However, even though we came off that cliff, there really has been no change in my belief of the causes of why we're where we are at today. The only difference is quite frankly we are not at risk of being swept away by those flood waters.

Here's a quick story to remind you of how tough things were 12 or 18 months ago. There was a guy who grew up in western New York not far from me named Ron Insana. He was one of the first broadcasters at FNN and went off to Los Angeles and got into production and then to work at CNBC. Here is a guy that was a lot closer to what was going in that period between September and March than I was. He was down in New York and managed a hedge fund down there and was very connected with people there. He told me that he and quite a few people down there had their spouses going to the bank every day taking \$5,000 of cash out and just sticking it under the mattress. They were that unsure about whether they were going to be able go to the bank and get their money out or not. Those who were in the know or those who were close to it were quite frankly that concerned. So certainly with all the credit to the Federal Reserve and to the Treasury and the others who really did take us off the edge of a cliff.

I look back over that year that has passed since I was meant to be here last time and our single greatest accomplishment may have been to kind of shift the deck chairs on the Titanic. There is still a hole in this ship and it is still taking on water. You might say given all the talk and certainly the rebounding equity markets that it may signal that we are out of the woods. Why do I believe that there are still these challenges in front of us? Why do I believe the boat is still taking on water? Well to put it as simply as I can it is because of the lack of leadership and the lack of confidence that comes with proven strong leadership. That lack of leadership is also the strongest case for another leg down. I don't think we are in a double dip scenario but if we take another leg down I believe the lack of leadership will be the

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cause of it. The need for leadership has never been greater and the void has never been greater. Think about for how long the leaders got it wrong. They thought we

needed to prop up the housing market, but we really needed to shrink the housing market. They thought we needed to prop up Wall Street, but we really needed to shrink Wall Street. They thought we needed to boost consumer spending, but we really needed less spending and we needed more savings. Now consider the health care reform legislation that was just signed into law. Do you think we might look back someday and say our leaders got it wrong? The banking system still has too much capacity. Price discovery is not yet complete in the investment and the loan assets on the books of banks. The community banks which certainly dominate this part of the country have done a much better job and haven't posed the same systemic risk. Whether it is because of the impact of deteriorating commercial real estate loans or other loans or investments you will still continue to see bank failures every Friday. You will continue to see the FDIC take banks over every Friday. The markets are really only alive thanks to all of you. Why do I say thanks to all of you? Because you have agreed to take on your share of new debt which will undoubtedly exceed 4 trillion dollars to fund both stimulus and deficits through fiscal 2011. Now, while the bailouts have certainly been necessary, time will tell how effective and most importantly how sustainable these programs

will be. You know many believe the only effective stimulus plan in the world has been that in China. That has been driven certainly by using monetary easing policies and by throwing money out over the land with public spending; we certainly see that in the U.S. It has also been on the back of very aggressive state mandated bank lending which they can do over there and an artificially low currency. Think about what's happening here at home. There is a back room where the U.S. government is printing money on this side of the room, and they are buying the paper on the other side of the room. Now some of that buying paper is going to stop today and we will see what happens but the money supply in the United States is up 100 percent from where it was before this began. What is interesting is that this all occurred at a time when it was pretty clear to everyone that it was excess leverage at all levels that really built this house of cards that finally collapsed.

So how did we get such a perfect storm? How did we over leverage an entire system? It is actually a very short list of culprits-three that I can think of. First the role of the financial industry. In their search for earnings that drive share price they created off balance sheet or structured products that either weren't well understood or really underestimated what the counterparty credit risk was. The second culprit was the role

of the government in their misguided belief that everyone should own a home. Also more recently that the government is exempt from balancing their budget and that they can spend more than they take in on a consistent basis. Finally we have to bring the role of the consumer in this and the consumer had the belief that they should live as well as their neighbors whether they can afford it or not.

So we have no choice right now but to continue moving through this deleveraging process we are going through. Irrespective of what the government does with policy or stimulus consumer spending has gone down. It is not going to return to the levels it was before because you are going to take that leverage piece out of it, so consumer spending will be less. The consumer still has some real issues out there-unemployment, underemployment and still a lack of confidence. We are going to have something new. A house is going to be a place to live and not an investment or your retirement account. The standard of living for virtually everyone in the developed world will be lower. You can't borrow your way to prosperity either privately or publicly and the government can't take the pain away. They might stretch it out in the best case. If they do the right things they will spread it out or if they do the wrong things they could make it worse in the long run.

So why does this feel so much tougher than the other recessions that at least some of us in this room have lived through? Some of you haven't felt this before. Let me give you one quick example of what it is. What normally happens in a recession is people lose their jobs and then they default on their payments and then you have a recession. What happened this time? People defaulted on their loans first because they had loans that they shouldn't have taken or shouldn't have been given. Now they are losing their jobs. Now you have something on the other side that feels different. Even though we have made progress you can't deleverage the consumer with fewer jobs. We have lost well over 8 million jobs since the recession began. You can't just slow job losses, eventually you need to add jobs. We need to add 150 thousand jobs every month just to stay even with the demographics of the country. Nor can you deleverage the government with growing deficits. What happens to this economy after this stimulus is spent, after we move it all through? What happens to this economy after the inventory levels are rebuilt? Some of the growth you have seen has been the rebuilding of inventory. Do policy makers have the courage to modify or change stimulus that isn't working? What will increased taxes do to consumer spending? This pain of deleveraging is going to have to

continue. There are going to be consequences and as we have learned they are both intended and unintended and they are going to include the guilty and the innocent. I would tell you that no one is immune.

All of you have your own well informed ideas of what is happening in the global and U.S. economy and they might be more accurate than what mine are. Certainly we are where we are today and we can't change that and there is no question that the outlook has improved significantly from what it was if I had been here a year ago or even a few months ago. But when you take a look at what's behind that improvement it is pretty clear that much of this recent growth has been driven by government stimulus that at the end of the day isn't sustainable for the long term. What we are doing is swapping public debt for levels of private debt that aren't sustainable. So in the short term the government is going to add billions if not trillions to our national deficit and the biggest problem with that is it takes away your flexibility to deal with future challenges. So how much real sustainable growth emerges over the next several quarters certainly remains to be seen. But our view is that the growth is going to be slow, this recovery into malaise and likely not robust enough to produce significant numbers of new jobs in the foreseeable future. In addition to the very real

personal hardships that come with unemployment especially long-term unemployment, we have a social contract in this country that is vastly underfunded and frankly dependent upon full employment going forward. This year, 2010, Social Security for the first time is going to pay out more than it brings in. So all you young people in the room are going to have to work extra hard to pay for all of us when we retire. It is going to be a difficult job. The problem is all that money they collected from us for Social Security to this time isn't sitting in a vault somewhere. We already lent that to the government, that cash is already gone. Another point is that the congressional budget office, the CBO, had projected this would happen in 2016. So they missed by six years which raises the question do you think they got this health care right and when it is going to hit us? You know I am very fortunate at CoBank for a number of reasons. One of the things is it really does give me a unique vantage point of the economy given our mission, the unique nature of our customer base and the vital industries that we serve across rural America. As you take a look at the economic horizon today I would tell you that we are trying to be as careful as we can be about distinguishing between cyclical developments that may take place as part of normal business cycles and those changes that

are truly characterized as structural in nature. I believe the biggest changes that will have the greatest impact on all of us involve a number of long term structural changes to the U.S. and the global economies. Let me just touch briefly on three of these structural changes.

One industry that is certainly undergoing fundamental restructuring is the financial services industry. For those of you who may have heard me around town previously know that I have been highly critical of this industry and the significant fall out that has occurred as a result of really poor leadership and risk management practices. As I said earlier, there remains a great deal of excess capacity that has to come out of the banking system. Certainly the government has done and is doing all it can to revive the banks. Many Americans are angry as they understand that this kind of strange Washington/Wall Street relationship has rewarded the least deserving people and institutions at the expense of disciplined individuals/businesses such as you see represented in this room today and certainly we see as we look out over our customer base. You know, Senator Dodd recently rolled out his proposed financial reform bill and there are a bunch of them that are rolling around out there. I will tell you I hold little hope that financial reform legislation will

really solve these issues. Much of the financial reform on the table is similar to our response to airline terrorism that by frisking grandma and taking away everyone's shampoo: it gives you the appearance of doing something but it really doesn't make anyone safer at the end of the day.

The second structural change is a big one -- the financial condition of the United States and quite frankly the larger public sector. The size of the federal deficit as well as what appears to be a real reluctance to address it in a serious and urgent fashion is going to have a profound effect on our economy and quite frankly, for us baby boomers, the legacy we leave for our children and grandchildren. Now it is true that we have had deficits many times in our history but the magnitude of where we are headed right now is of a different order. It really amazes me that the U.S. administration and Congress are quite frankly living just as the U.S. consumer did in the 2000s. They are living without regard for leverage. Conveying the enormity of that U.S. budget deficit is tough; millions, billions, trillions just sound too much alike. You want to get a better picture? Think golf balls, watermelons, and hot air balloons and that will get you an idea of what we are talking about. Last September the government ended the year with a deficit of about 1.4 trillion

dollars which is about 10 percent of the GDP. Now as a share of the GDP in this country right now taxes and other revenues are 15 percent lower and spending is 25 percent higher than at any time in the last 50 years in this country. If you look to 2010 and 2011 the government projects and I am willing to bet at least on the revenue side they are too optimistic, deficits of about \$1.6 trillion in 2010 and about \$1 trillion in 2011. While this country really has a great track record of addressing deficits it is just going to be much tougher this time. We have really drilled ourselves and are drilling ourselves a larger hole in the ship. When the economy began bailing water from the last deep recession which was in the early 80's federal debt amounted to less than 30 percent of the

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nation's GDP. At the beginning of the 1990s it was less than the 40 percent. Today it exceeds 50 percent of the GDP and is actually on its rise towards 80 percent. Even under the most optimistic projections that I

have seen out of the CBO it will be 100 percent of GDP over the next 10 years. That doesn't even include the 60 trillion dollars that we need to fund the off balance sheet liabilities to fund that social contract I spoke about, and that is before considering the new health care reform legislation. It also comes before adding a significant liability that home buyers, home builders and bankers who went out and used Fannie Mae and Freddie Mac as a federal credit card with a high credit limit from the Chinese. What did they do with it? They made a one way bet on home prices and they lost that bet. You know the government believes they can bring back a trillion dollars a year of demand in the U.S. economy that was previously fueled by credit. There was a trillion dollars that was hitting this economy only because we had too much credit. I have news. That demand isn't coming back. As it is with the banks, the leadership of this country has yet to offer a good solid business plan to demonstrate how we prevent the United States from becoming the world's largest sub-prime borrower.

The third and final structural change I mention relates to something called volatility or call it boom and bust. Volatility has clearly become the new normal in virtually every sector of this global economy; from the credit and equity markets, to commodities, exchange rates,

housing, manufacturing to retail, you name it. The range of that volatility is getting bigger and bigger and some of that is through event risk in a world that is reported on instantaneously 24 hours a day, 7 days a week, and 365 days a year. If you just think it was only a couple of months ago we had a number of commentators writing obituaries on the U.S. dollar as the dominant international reserve currency. But in the last couple months what has it been it has been the future of the Euro that has been the foremost in question as a result of poor financial discipline in Greece and Portugal and some other European countries. I would tell you that many of us in this room have certainly experienced that volatility in a very personal way in the past few years from the dramatic run-up in commodity prices at the end of '07 and '08 to the total disruption of the credit markets that we saw in 2009. These new higher levels of volatility require a fundamentally new way of operating for any business organization. First and foremost they place a much higher premium on the quality of leadership at both the board and at the management level. They also place a higher premium on risk management. Among that includes insuring your balance sheet stays strong and always maintain adequate liquidity. A lot of organizations died just because they ran out of

liquidity. You have to be able to withstand shocks from the system and especially from unplanned events. That is not only true for the businesses here in ND; quite frankly it is true for CoBank also. We have to live by the same standards.

You might ask me what all this means to CoBank and the greater Farm Credit System, including Ag Country who is represented here today. Fortunately, like CoBank, the System as a whole quite frankly continues to perform very well in all measures and continues to serve its customer/owners. That doesn't mean we don't have our share of issues. Right now there is pretty weak loan demand out there. There is certainly stress in some of the industries we support. There is a frailty in the liquidity investments we have on our books that are backed by home prices. We have the

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challenge of what does it mean to be a government sponsored enterprise? What does it mean to be a GSE? Maybe the greatest one is this overall high level of uncertainty surrounding legislation and regulation

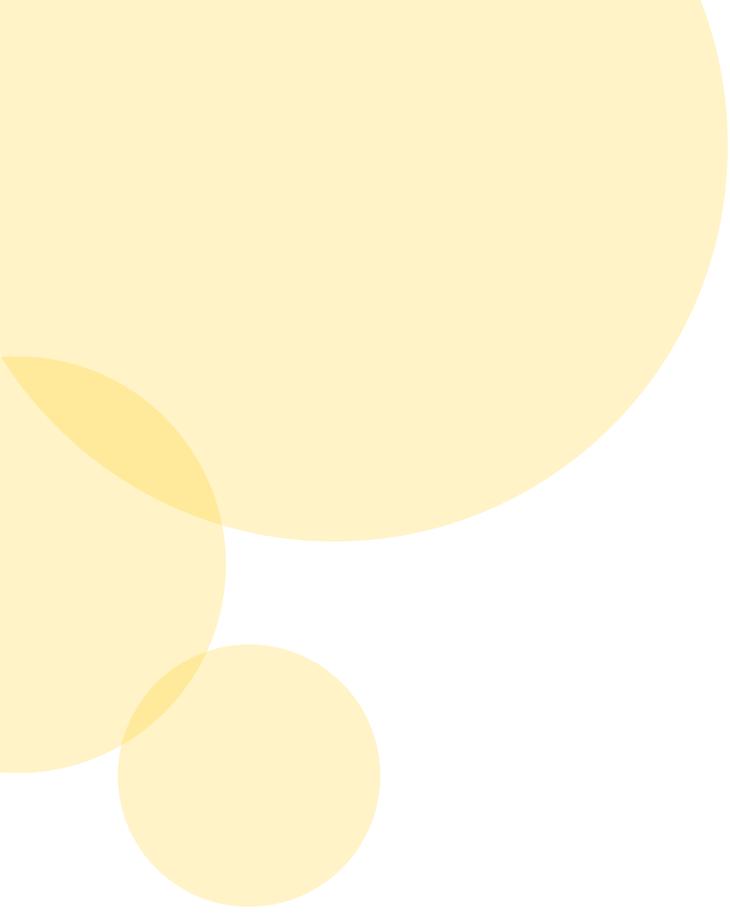
flowing from Washington, DC. I call it the “stroke of the pen” risk. Now in spite of those issues CoBank and the Farm Credit System remain well positioned to continue fulfilling our government mandated mission to serve as a source of dependable credit for agriculture and rural America in good times and bad and maybe most importantly for generations to come. We believe that promise more than anything underscores the unique benefits of the cooperative model on which CoBank is built. That model provides a powerful alignment of interest between CoBank, between Ag Country and our customer/owners. That cooperative model, I would tell you, one of the real strengths is that it remains oriented to a long-term perspective versus short-term results. If you aren't sure about that, think about the track record in the public sector right now trying to obtain short-term results. Are we getting short-term results, some of which we need, and mortgaging the future for it? That is precisely why organizations such as the Burdick Center for Cooperatives are so vital as we continue forward. I would tell you another sound reason for optimism for all of us here today is the long-term promise that U.S. agriculture holds for us. Ironically this increased globalization that has contributed so much to the economic volatility we've seen

in recent years is the same trend that bodes so well in the long run for U.S. agribusiness. It has been estimated that by 2050 we are going to have to double the world's level of food production to feed the population which at that time, will exceed 9 billion people. That is a tall order, especially if you consider that there is only about 10 percent more arable land that can be put into production without intolerable environmental consequences. I am confident that U.S. agribusiness is up to meeting that challenge. Our nation is a world leader in terms of the quantity, the quality, the efficiency, the nutritional value and the safety of the food products as well as the value chain that delivers them to a growing world market. This is an area where the U.S. does enjoy a strong and sustainable competitive advantage. Global demand for high quality food products will only continue to grow and U.S. agribusiness will be essential to meeting and satisfying that demand. That also bodes well for the other vital industries that CoBank serves to support U.S. agriculture in America's rural communities. The country's need and demand for reliable and affordable power for water and for communications is also going to continue to climb. I can tell that our customers that are in those industries are well positioned to serve the rural economy across the country. But I would tell you that the

most important reason for hope is the quality of leadership that we enjoy in rural America today. It is why we need the ongoing work of universities such as NDSU. I mentioned earlier that it really was a failure of leadership that lies at the heart of the banking crisis and many of the political difficulties that our nation faces. Rural America is fortunate not to have that problem. Anyone who is lucky as I am to spend time with some of the people that are assembled in this room or the leaders of our other customers around this country will quickly understand and appreciate that fact.

So what will it take to hasten the recovery from malaise or prevent us from slipping back in? It is going to take leadership and it is going to take leadership that demonstrates first and foremost the will to lead. Only a few people like the risky business of leadership and possess the will to lead. It is going to take leaders who have a vision that is bigger than themselves. Because if you don't have a vision that is bigger than yourself people will follow you, but they won't follow you very far. It will take leaders who have an awareness of what they do well and what they don't do well. That will build a team around them that can do what they can't do and the self

confidence to bring in people that are better than they are. Finally it will take leaders who are easy to understand, who don't confuse sophistication with complexity. You know great strategy starts with simple ideas that are well communicated; the difficulty is always in the execution. So the search for leadership in post crisis malaise is vital. We really need to do more than straighten the deck chairs on the Titanic. We can't continue to bail this ship out. We have to find leadership that is capable of going in and fixing the hole. What will it involve? It will be pretty simple. It will involve courage on a part of a few leaders and unfortunately it will require sacrifice on the part of all. Thanks for having me.



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