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Payment Limitations and U.S. Farm Policy

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To an industry lobbyist, the role of government is to adopt programs and regulations that increase profits for the firms in the industry. Steel and timber lobbyists argue for higher taxes on imports; lobbyists for power generators argue for lower air quality standards; and farm lobbyists argue for higher support prices and stronger protection from imports. When government responds to lobbying pressure and adopts a new program or regulation, all firms in the industry typically have access to the benefits. And because the benefits often are in proportion to the level of production, the largest firms obtain the greatest benefit. Thus, President Bush’s import taxes on steel benefit the largest steel companies the most. In agriculture, the best example of this principle is the sugar program. The program limits U.S. imports of sugar, thus costing U.S. consumers approximately $1.4 billion per year through higher prices. According to a recent Heritage Foundation study, Alfonso and Jose Fanjul, owners of Flo-Sun, Inc., in Palm Beach, Florida, benefit by approximately $65 million per year from producing sugar in Central Florida. Furthermore, they obtain an additional $60 million per year because they are given a portion of the U.S. import quota, which allows them to import inexpensive Dominican sugar into the high-priced U.S. market.

That the benefits from government intervention in agricultural markets accrue to the largest farms troubles many who otherwise support farm subsidies as a means of ensuring adequate incomes for farm families. Making sure that farm families were not financially destitute was arguably the original purpose of farm programs in the 1930s. A large proportion of the U.S. population lived on farms and in rural areas, so program benefits flowed much more widely and uniformly than they do now. But as concentration of farmland ownership increased over time, so too did concern over the concentration of farm program benefits. Congress recognized this concern in the 1970 farm bill by placing limits on farm program payments.

The payment limitations issue was one of the most divisive debates of the 2002 farm bill. Computers, the Internet, and the Freedom of Information Act allowed the Environmental Working Group to create a web site that revealed that most payments went to relatively few farmers. The resulting publicity put supporters of farm programs on the defensive and gave some impetus to those who argued for an overhaul of payments. The debate highlighted strong regional differences on the issue. Senators and representatives from the Midwest generally supported some tightening of limits. Those from the South generally opposed any new restrictions because southern crops receive relatively high per-acre payments.

Congress passed the new farm bill with few meaningful changes in payment limits. But one outcome of the debate was the appointment of a USDA commission to study the impact of payment limitations on agricultural producers and related entities. The commission report is expected in May or June. An examination of the economics and politics of payment limits will give some perspective to the outcome of the commission report. A brief review of the recent history of payment limits is a useful place to start.

CURRENT PAYMENT LIMITATIONS AND THEIR EFFECTS
The 1996 farm bill limited Production Flexibility Contract payments (commonly known as AMTA or
“Freedom to Farm” payments, loan deficiency payments, and marketing loan gains. The limits were set for a “person,” with a person being defined as an individual, limited liability partnership or company, corporation, or association that has a distinct and separate interest in the land or commodity and maintains separate responsibilities, accounts, and funds from others involved in the operation. For a more detailed description of payment eligibility requirements and limitations, see the Farm Service Agency fact sheet at http://www.fsa.usda.gov/pas/publications/facts/payelig01.pdf.

Payment limits were set at $40,000 per person for AMTA payments and $75,000 per person for the sum of loan deficiency payments and marketing loan gains. Persons had to be actively engaged in farming to be eligible. A husband and wife were considered as one person unless they requested to be considered as separate persons and met the exception requirements. Persons were limited to receiving payments on three entities. On the second and third entities, persons were limited to a 50 percent ownership share or less. This means that participants could have received up to $80,000 in AMTA payments and $150,000 in marketing loan benefits per year. In addition, Congress allowed unlimited use of commodity certificates or forfeiture settlements of marketing losses so that the $150,000 limit could be circumvented.

The seriousness with which Congress viewed these payment limits is open to question, because once they started to actually bind, they were loosened. During the downturn in crop prices in the late 1990s and early 2000s, Congress authorized temporary changes to the payment limitation guidelines. The limit on marketing loan benefits was raised to $150,000 per person for the 1999, 2000, and 2001 crop years. In combination with the three-entity rule, this meant that participants could receive up to $300,000 in marketing loan benefits. The limits on AMTA payments were not changed because AMTA payments were fixed. The additional marketing loss assistance payments made in these years were not subject to AMTA limits.

The 2002 farm bill authorizes a new countercyclical price program and allows updating of program bases for farm programs. Congress adjusted the structure of payment limitations to account for these changes. The combined limit on loan deficiency payments and marketing loan gains has been returned to $75,000 per person. Direct payments are limited to $40,000 per person. Countercyclical payments are limited to $65,000 per person. The three-entity rule remains in effect, allowing participants to receive up to $360,000 per year from these programs. Again, the use of commodity certificates or forfeiture settlement of marketing loans does not count against marketing loan benefit limitations.

Senator Charles Grassley introduced a bill in March 2003 that would cap direct payments at $20,000, countercyclical payments at $30,000, and the combination of loan deficiency payments, marketing loan gains, commodity certificates, and forfeiture of loans at $87,500 per person per year. With the three-entity rule, total benefits would be constrained to $275,000 per year. If passed, this bill—Senate Bill 667—would greatly increase the number of farmers affected by payment limits.

For example, for the current crop year, only cotton, rice, and peanut prices are low enough to trigger countercyclical payments. Countercyclical payments are projected to be 13.7¢ per pound for cotton and $1.66 per hundredweight for rice. Given payment yields of 605 pounds for cotton and 48.15 hundredweight for rice (their national averages under the 1996 farm bill), program participants with 923 base acres in cotton or 957 base acres in
rice would hit the countercyclical limit. According to the 1997 Census of Agriculture, 10 percent of cotton farms and 4.5 percent of rice farms had over 1,000 acres. Under the Grassley proposal, 426 acres of cotton and 442 acres of rice would hit the limit. Census data shows that 28.8 percent of cotton farms and 19.9 percent of rice farms exceeded 500 acres. In addition, cotton and rice producers are the main users of commodity certificates. Their inclusion in the payment limitation for marketing loans would have a large impact on these crops. This might explain why senators and representatives from the South and California are so opposed to payment limits in general, and to Senate Bill 667 in particular.

**DO FARM PROGRAMS INCREASE CONCENTRATION?**

Advocates of stricter payment limits typically argue that making large payments to wealthy farmers simply is not fair and that adding to the wealth of large farmers enhances their ability to get even bigger. The fairness of the issue is a political judgment but we can say something about the conditions in which payment limits increase concentration in agriculture.

The ability to expand a farm operation depends on obtaining financing, which in turn depends on the prospective returns from the expansion and the current financial condition of the farm. If two farmers are interested in a tract of land and they have identical cost structures and management abilities, then prospective returns from investing in the tract of land will be identical, which suggests that each farmer’s willingness to pay for the land is identical. But the ability to pay for the land may depend on credit availability. A lower cost of capital will give an advantage. In general, the cost of capital will depend on the riskiness of the venture. If one of the farm operations is much larger than the other, then the additional riskiness from expansion, expressed as a percentage of current cash flow or net worth, will be much less. Thus, the cost of capital will be lower for the larger farmer. And, of course, enhancements of cash flow from government payments will only increase this advantage. In this sense, farm programs can increase land ownership concentration.

Of course, there are other reasons why large farmers may have an advantage in bidding for land. Advocates of payment limits argue that large farms should not be able to use government subsidies to help finance expansion. Rather, market returns should dictate any expansion or contraction. Strict payment limits would reduce the willingness to pay for land if a farm is already above the limit, thus giving an advantage to smaller farmers in competition for land. Adoption of lower payment caps would not necessarily result in a dramatic reduction in the price of land if there were many farmers below the payment cap. But the extra advantage that large farmers have in bidding on land would disappear.

**Are Payment Limits Consistent with Farm Policy Objectives?**

Most advocates of stricter payment limits argue that farm programs should be designed to maintain and strengthen the financial condition of farm families that own and/or operate small- to moderate-sized farms, as was their original intention in the 1930s. Supporting the wealth of large farmers does not seem consistent with this objective. Judging Congress by its actions rather than its rhetoric, we must conclude that the objective of the farm program has changed. After all, Congress makes payments when prices are low without regard to production costs, makes disaster payments when yields are low without regard to prices received, and makes no account of the actual financial conditions of farm families before cutting checks. That is, there is little targeting of payments and absolutely no means tests. Moreover, it is well documented that average farm family income meets or exceeds non-farm family income. So, without a means test, most farm support flows to families that have higher-than-average incomes.

We cannot conclude, however, that maintaining farm income is not the objective of farm programs. As Senator Lugar of Indiana argues, the farm policy actions of Congress over the last 10 to 20 years are consistent with a policy objective of maintaining national net farm income at a particular level. Given that so few commodities receive subsidies, perhaps it is more accurate to say that Congress wants to support the farm income generated by a chosen few commodities.

Maintaining national or aggregate farm income is analogous to an industrial policy objective, because what matters is aggregate income in the industry. Any payment to any participant in the industry helps fulfill the objective. Maintenance of family income, on the other hand, requires an income means test, much like we have with food stamps and other social welfare programs. A recent USDA study showed that farm family income could be supported at a far lower cost than that of the current commodity programs.

Even if Congress were to decide to target program benefits to farm families in financial difficulty, it is not clear that this would be best accomplished through stricter payment limits. The most direct tool for achieving this policy objective is the tax code. For example, a government payment could be made to farm families that do not meet a certain income threshold.

What then can be said about arguments for and against payment

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2 percent to a stacked gene variety having both insect and herbicide resistance. Statewide, 41 percent of the 2002 Iowa corn crop was genetically modified: 31 percent was Bt corn, while 7 percent was herbicide resistant and 3 percent was a stacked gene variety. The 2003 intentions survey shows nationwide that corn producers intend to increase their Bt corn plantings by 4 percentage points, while the shares of their acres planted to herbicide-resistant varieties remain unchanged, and stacked gene varieties will increase by only 1 percentage point. Iowa growers intend to sow 47 percent of their corn acreage to genetically modified varieties. The share of intended Bt corn increases to 38 percent, the share of stacked gene corn increases to 4 percent, and the share of acreage planted to herbicide-resistant corn falls to 5 percent.

Nationally, the intentions for 2003 show continued growth for herbicide-resistant soybeans, with 80 percent of the soybean crop allocated to biotechnology varieties compared with 75 percent last year. Iowa soybean producers indicate that 82 percent of the new crop will be herbicide resistant compared to 75 percent in 2002.

Livestock
The March 28 USDA Hogs and Pigs report indicated an expected decline in hog numbers and the continuing liquidation of the breeding herd. The inventory on U.S. farms is lowered to 58.1 million head of hogs, down almost 2 percent from both a year ago and last quarter. The breeding herd, at 5.96 million head, is 4 percent below last year’s level and 1 percent below the level of the last report. The March inventory of market hogs, at 52.2 million head, is 2 percent below last year and 3 percent below the December inventory, which is indicative of lower marketings this spring and summer compared with last year. Consistent spring and summer farrowing intentions reported by U.S. hog producers are both 3 percent below the actual farrowings at these periods last year, suggesting that marketings this fall and winter will also fall considerably lower than last year’s levels.

However, the report had little positive impact on prices, as markets waited for further symptoms of moderating hog slaughter in light of the recent discrepancy between the actual slaughter numbers and the numbers calculated from the official reports. Market observers speculate that the projected lower beef and poultry production is likely to help sustain the hog price rebound. Pork stocks in cold storage continue to exceed last year’s levels but are expected to decline in the future. Having achieved significant rates of growth in pork exports, the pork industry is now more exposed to volatile international markets, as well as foreign meat safety regulations, trade barriers, foreign competition, and freight costs. Accounting for changes in productivity, strong demand for bacon, and new pork products, prices are expected to reach levels profitable for producers this summer before declining in the fall, according to some estimates.

In Iowa, the inventory of market hogs was estimated at 14.9 million head, down 1.3 percent from March 2002, a bit lower than the nationwide level. However, the state’s breeding herd showed a significant drop of 7.1 percent, indicating a higher number of out-of-state feeder pigs.

Farm Income
Statewide cash receipts, at $11.16 billion, fell slightly in 2002 compared with last year’s receipts but are nearly on a par with the five-year average. While the revenues in the crop sector rose 11 percent, cash receipts for livestock fell 14 percent below last year’s income. The increase in crop cash receipts has been reflected in rising cash rental rates for cropland. Iowa cropland rates averaged $120 per acre, up $3 from last year. Fiscal year government payments for Iowa fell from $2.302 billion in 2000 to $1.972 billion in 2001, mostly because higher grain prices reduced payments under marketing loan programs.

Payment Limitations
limits? Opponents and proponents of stricter payment limits will argue endlessly about the fairness of large payments to farmers. But this argument misses the point. Just because large payments are made to individual farmers does not mean that the objectives of farm programs are not being met. Congress has demonstrated repeatedly that it wants to subsidize a particular subset of U.S. crops. And it is difficult to subsidize a heterogeneous sector of the economy without bestowing the largest portion of subsidies on the largest firms in the sector. Furthermore, it could be argued that farm programs exist precisely because they make large payments to wealthy farmers. That is, the potential for large subsidies gives the largest farmers a reason to lobby Congress to continue farm programs.

So, what we are left with is a political decision about who gets what portion of farm program benefits and the purpose of the programs. Given that current farm policy works like an industrial policy for chosen commodities, there is no economic efficiency rationale for payment limits. Political and equity concerns will decide the issue.