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Does the New Farm Bill Reduce Risk?

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Farm programs administered by the U.S. Department of Agriculture have had many objectives over the years. Protecting farmers from the risk of falling commodity prices has been one of the most important ones. A number of different mechanisms have been tried, including price supports, loans, supply control incentives, and various types of payments. The 2002 Farm Bill contains three different types of payments, each relates differently to commodity prices.

Direct Payments

Direct payments have replaced other farm payments received in recent years that were known variously as AMTA, Fair, Market Loss Assistance, and Oilseed Payments. Direct payments apply to all program crops, and are determined by the acres in each crop base and the program yield for that crop. A fixed rate per bushel is paid, $.28 for corn and $.44 for soybeans. However, direct payments are made on proven yields from the early 1980s and on 85 percent of the crop base acres, so based on current yields payments are only about two-thirds the stated rate.

The most important feature of direct payments is that they are fixed for the next six years once the crop bases and program yields have been established. What happens to acres, yields and prices after that will not change the value of the payments. So, direct payments have essentially no effect on price risk, except that they provide an extra cash infusion in addition to the revenue received from the market.

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Counter Cyclical Payments
The most discussed feature of the new commodity programs has been the counter cyclical payment. Counter cyclical payments are paid when the average national marketing year price is below $2.32 for corn and below $5.36 for soybeans. The yearly average price is an average of cash prices paid during September to August following harvest. It is weighted by the quantity of grain sold in each month and in each state. Yearly average cash prices in Iowa are generally about $0.10 per bushel below the national average.

Payments are made in three installments during the marketing year. Payment rates are set at the difference between the final season average price and the trigger prices mentioned above. The maximum payment rates are $0.34 per bushel for corn and $0.36 per bushel for soybeans. However, payments are based on only 85 percent of the base acres for each crop. Moreover, program yields are only 93.5 percent of recent average yields, or even less if old crop bases were retained. Thus, for each $0.10 that market prices fall below the trigger levels, the actual counter cyclical payment is about $0.08 per bushel or less.

In addition, counter cyclical payments are based on historical crop acres and yields, not current production. For example, if a farm has a 100 percent corn base but is planting 50 percent corn and 50 percent soybeans now, the counter cyclical payment provides double price risk protection for corn, but none at all for soybeans.

So, while counter cyclical payments are tied somewhat to commodity prices, it is a rather strange relationship. They do not take the place of forward pricing tools or crop revenue insurance when it comes to price risk management.

Loan Deficiency Payments
During the low grain prices of recent years, corn and soybean producers became very adept at applying for loan deficiency payments (LDPs). The new farm bill retains the same mechanism. Market loans are also available, just as before. Any time that local market prices, as measured by the posted county price in each Farm Service Agency office, fall below the county loan rate for a given commodity, a producer can apply for a loan deficiency payment equal to the difference. Payments are made on bushels that have not yet been sold or “LDPed.”

Because loan deficiency payments are paid on bushels actually produced each year, they provide very direct risk protection against low prices. The average loan rates in Iowa are $1.90 for corn and $4.93 for soybeans, but they vary by county. The 2002 farm bill raised county loan rates for corn by $0.12 per bushel in Iowa, and lowered rates for soybeans by $0.26.

The charts on this page show how the total revenue received per bushel changes as Iowa market prices move higher. Direct payments are made regardless of price. Loan deficiency payments diminish as the market price rises to the loan rate, and counter cyclical payments disappear when the national price exceeds the
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trigger price level. Note that the minimum total revenue per bushel is around $2.33 per bushel for corn and $5.50 per bushel for soybeans. Without the direct payments the minimum revenues are $2.14 and $5.21, respectively. These values will change some if current acres and yields differ from production levels recorded from 1998 through 2001.

In summary, LDPs provide a price floor for actual production. Counter cyclical payments provide some additional price protection. Both of these are fixed through 2007, except that the loan rate for corn will drop by $0.03 in 2004. Neither of these features provides any protection against yield risk. Farmers in the Great Plains and the eastern Corn Belt found this out in 2002. Many of them suffered large yield losses due to drought, yet, since prices increased, they received only the direct payment under the new bill. As a result Congress approved emergency disaster payments for some affected areas.

Purchasing QFOBI Assets from the Estate *

Typically, assets in a qualified family-owned business interest (QFOBI) pass by inheritance to qualified heirs. The statute requires that the aggregate value of the decedent’s qualified family-owned business interests exceed 50 percent of the adjusted gross estate (gross estate less allowable deductions), and that amount or more must be “acquired by any qualified heir from, or passed to any qualified heir from, the decedent....” The question is whether QFOBI assets can pass to qualified heirs by purchase with eligibility retained for the family-owned business deduction and, if so, what the income tax consequences of the sale are to a qualified heir or heirs.

Purchase of land under special use valuation from the estate

Many of the provisions of the family-owned business deduction parallel those for special use valuation. For purposes of special use valuation, the statute specified that, for eligibility for the provision, it was necessary for qualified real property to be “acquired from or passed from the decedent to a qualified heir of the decedent.” Until a 1981 amendment was enacted, property was deemed to have been acquired from the decedent if so considered under I.R.C. § 1014(b) which meant that land was ineligible if purchases occurred or options were exercised before the land passed to the qualified heirs. The fact that the title to realty passed immediately to the heirs as a matter of state law subject to being retaken by the estate representative to pay debts and costs apparently was sufficient to meet the test.

The 1981 amendment, retroactive to January 1, 1977, permits property to pass by purchase and not lose eligibility for special use valuation. Under the 1981 amendment, land is considered to have been acquired from or to have passed from the decedent if:

1) the property is so considered to have passed under I.R.C. § 1014(b) relating to income tax basis of property acquired from the decedent;
2) the property is acquired by “any person” from the estate; or
3) the property was acquired by “any person” from a trust (to the extent the property was includible in the decedent’s estate.)

Purchase of qualified family-owned business interests

Under the provision for a deduction for qualified family-owned business interests, the assets continued on page 4