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A panel study of Iowa farm financial conditions: 2000-2007

by Robert W. Jolly, professor, 515-294-6267, rjolly@iastate.edu and Darnell Smith, extension program specialist

This article highlights the financial performance of a panel – or group of farm businesses over several years. The data used in our analysis are obtained from the Iowa Farm Business Association (IFBA). The IFBA is an independent farm accounting association managed and controlled by its members. The full version of this report is available from ISU Extension Publications as FM 1883.

The IFBA data consists of larger farms particularly those operating more than 500 acres. The data does not represent the entire farm population but does represent the commercial farm population in Iowa. According to the most recent census, farms larger than 180 acres – those more typified by the IFBA data – made up approximately 50 percent of all farms in Iowa and produced 83 percent of the total value of farm output.

History

Figure 1 presents nominal aggregate net farm income and farm program payment information for Iowa since 1980. Note that farm payments are included in farm income and consequently the figure shows how much of net farm income came from government farm payments of all types. Our focus in Figure 1 is 2000-2006, the period covered by this study. From 2000-2003 farm incomes were close to historical average levels. However during 2000 and 2001 most net farm income came directly from farm payments. Income declined slightly the next two years. The decline can be attributed in part to reduced government payments resulting from improving corn and soybean prices as well as declining pork prices. In 2004 income increased sharply and then fell over the next two years. In general, farm income at the end of the period significantly exceeded income at the beginning.

Aggregate farm income improvement was driven, in part, by strong corn and soybean prices in 2004, significant farm program payments in 2000, 2001 and 2005, strong growth in corn yields and continuing profitability in livestock production. The impact of the current ethanol boom is not reflected in the aggregate income data however. The 2006 average prices received for corn and soybeans in Iowa were $2.13 and $5.55 respectively. The sharp ethanol-driven increase in prices began in October, 2006.

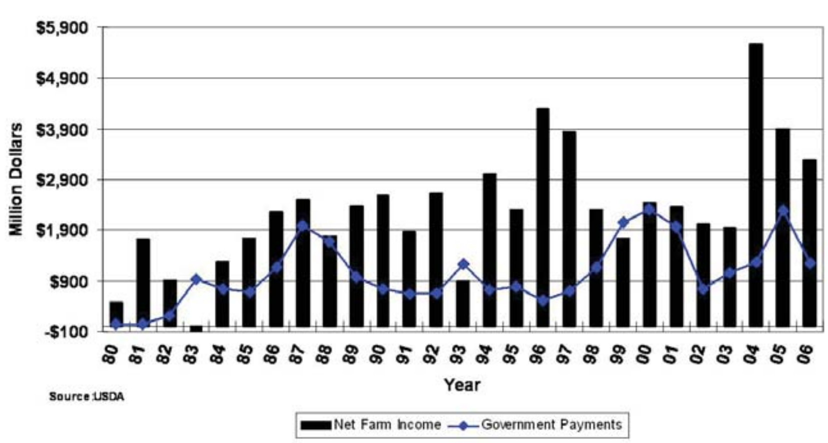
The story that emerges from the aggregate farm income data over the past seven years is one of above average earnings, considerable income volatility and reliance on farm program payments to provide some degree of stability during low price years. Examining farm income at the state level, however, provides little insight into the income situation for individual farm families. How income is distributed among farmers or groups of farmers is important in addressing the issues stated earlier in this paper.

Comments

In the full report, we examine the financial performance of a panel of Iowa commercial farm businesses from 2000-2007. As in previous studies, we demonstrate the wide variability in financial performance across firms facing similar economic conditions.

Within the IAFBA data set, the top 20 percent have improved their financial standing significantly over the period. The lowest 20 percent have made little financial progress. Between these extremes we see farm businesses, at varying degrees, meeting outside cash obligations and strengthening their equity position.

Figure 1. Iowa Net Farm Income and Government Payments: 1980-2006



This study provides a snapshot of Iowa commercial farmers' financial strengths at the beginning of the ethanol-fueled price boom and a new Farm Bill. We expect, for a few years at least, that commodity prices will continue to be strong. The grain price increases may result in cutbacks in livestock profitability depending on the growth in meat demand. Ultimately strong farm profits will be bid into land, rents and other asset values, resulting in tighter more volatile margins.

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If commodity prices do remain strong, one of the unresolved questions is how the farms represented by the panel will fare. Will a rising tide lift all boats or will the range in adjusted cash income become wider? The lower 20 percent group has higher debt-to-asset ratios and is more dependent upon government payments as a source of cash income. This group may be more vulnerable to changes in the cost structure of agricultural assets. And, it is unclear how the new farm bill will influence farm income and equity growth across this rather broad spectrum of farm structures. Farm size, enterprise mix, financial condition and human capital will all contribute to the ability of farmers to adapt to changing conditions. The full version of this report is available at: http://www.extension.iastate.edu/Publications/FM1883.pdf

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Congressional research service report to Congress on CRP is incomplete and misleading

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On April 10, 2008, the Congressional Research Service released a report to Congress on the Conservation Reserve Program (CRP) which does not recognize the key issues in the controversy and which is both incomplete and misleading. Inasmuch as the Congressional Research Service was set up as the research arm of Congress, the contents of the report, coming at a crucial time when the 2008 farm bill, H.R. 2419, is in conference committee, are particularly important.

The key shortcomings of the CRS report

On the self-employment tax issue, which is of central importance, the CRS report commences the analysis by leading the reader to assume that the issue of exclusion of CRP payments from self-employment tax has arisen only in recent years and that the argument is all about the breadth of the exclusion from self-employment tax liability. The report dismisses the fact that CRP payments were historically not subject to SE tax for those who fell short of carrying on a trade or business (those who were retired, those who were disabled and those who were mere investors) from the time of the first signup under the CRP program in 1986 until IRS announced a change in position in 2003. Thus, it is misleading to omit any mention of the longstanding tax treatment of CRP payments. It is also misleading to treat the issue as involving a loss of revenue when the former exemptions are restored as the Congressional Committees have repeatedly done in their calculations. Allowing IRS to change the law as evidenced by Section 1402(a) of the Internal Revenue Code and resist challenges on the ground that any relaxation of the revisionist rule would constitute a cut in tax revenue is not only disingenuous; it goes well beyond the proper role of IRS as was extensively discussed in 1998.

What is at issue here is an attempt by the Internal Revenue Service to redraw the line between income from a trade or business (which triggers self-employment tax) and income from an entity falling short of the trade or business test and, therefore, is not subject to SE tax. Nowhere in the CRS report is that test even mentioned and nowhere is Section 1402(a) of the Internal Revenue Code cited. With the IRS position taken in the 2003 ruling and the 2006 Notice, plus the revenue ruling threatened in the 2006 Notice, there would be no investment activity, even those held by those in retirement or disabled, that would not be subject to SE tax. The attempt by the Service to redraw the line of what constitutes a trade or business goes well beyond the CRP issue. If the IRS position prevails, it will pose a serious threat to the meaning of "trade or business" in all sectors of the economy.

No challenge to IRS authorities cited in support of the service position

The CRS report makes no mention of the lack of authority in support of the IRS position on imposition of SE tax on CRP payments falling well short of the trade or business test. As

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