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AgLetter

NEW FARM BILL ENACTED

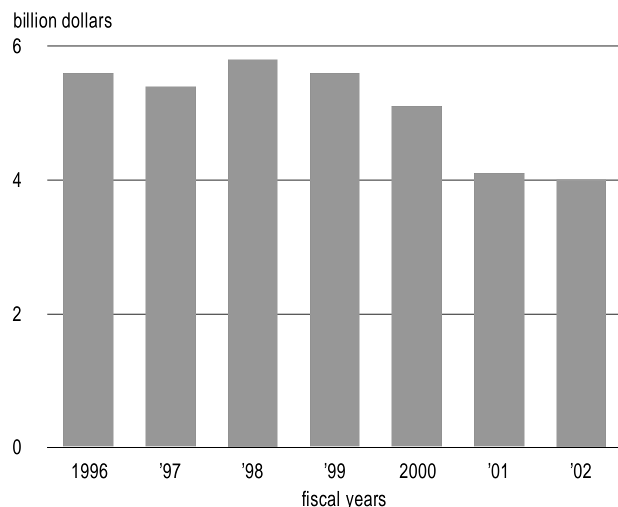
President Clinton signed new legislation on April 4 that will govern farm income and price support programs for the next seven years. Dubbed the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, the signing brought an end to a debate that lasted far longer and took more twists than had been expected. Like earlier farm bills, this one is broad based, encompassing issues related to trade, conservation, food assistance, credit, rural development, research and extension. With respect to farm income and price support programs, the distinguishing features of the new Act are the fixed crop payments irrespective of crop prices, the flexibility given to participants for determining what crops to plant, and a restructuring of the dairy support program.

The thrust of both the bill and the debate took several unusual twists during the prolonged period leading to enactment. It was initially expected to be a five year bill that would be completed in 1995. But with the unexpected change in Congressional leadership that followed the November 1994 elections, the focus shifted to a seven year bill to coincide with a renewed emphasis on eliminating federal budget deficits. The debate really started in 1994, a year that produced a 20-year low in hog prices and a record crop harvest that pushed corn prices to a six-year low. Those market conditions led to considerable pessimism as the thrust of the debate focused initially on a phase down of the support programs and later shifted to a discussion of the large expenditure cuts needed to be consistent with eliminating budget deficits. Perhaps more than anything else, that pessimism was captured in widespread concern about the negative implications of the support program cuts for farmland values.

During the long debate, conditions in agriculture changed markedly. Moreover, the political realities that prevailed in the end de-emphasized both the goal of eliminating the budget deficits and the views among some participants that this farm bill would mark the phase-out of farm support programs. When enacted earlier this month, hog prices had nearly doubled from the cyclical low of October, 1994 and grain prices were setting new record highs. As the underlying conditions in agriculture changed, the “base-line projections” of the cost of continuing existing farm price support programs retreated significantly. Accordingly, the debate shifted from justifying cuts of as much as $15 billion in expenditures over five years to defending a plan that, as ultimately enacted, would cost the federal government considerably more, at least in the first couple of years. And because federal outlays for farm income and price support programs for the next couple of years will be higher than would have been the case under the old farm bill, some observers are now talking about the positive effects of the new bill on land values.

Other twists also surfaced during the debate. Perhaps more than past farm bill debates, this one started with some new proposals—like revenue assurance—for changing the mechanism by which crop farmers’ incomes are supported. But the “Freedom-to-Farm” proposal offering fixed, but declining payments irrespective of commodity prices that was ultimately enacted, was not introduced until late in the debate (August, 1995). Moreover, much of the original focus on phasing down federal farm income and price support programs was interpreted to mean a phase-out of the federal government’s role in supporting agriculture. But since the new Act only amends, rather than repeals the so-called permanent farm program legislation,

Annual PFC payments in the new bill sum to $35.6 billion



there is still little certainty that the federal government will abandon agriculture after 2002.

The chief distinguishing feature of the new Act is the so-called production flexibility contracts (PFCs) which commit the federal government to making annual, predetermined payments to participating farmers over the next seven years. Those payments will no longer be dependent on the program crop acreage that farmers plant or on the market prices they receive for the crops they do plant. The Act calls for some $35.6 billion in PFC payments spread over the seven fiscal years ending in 2002. Nearly half (46 percent) of those payments each year will go to participants with a corn base. In general, the contract payments will be available to producers (landowners and/or tenants) on land having an established base acreage for one or more program crops and which was enrolled in the price support program in at least one of the last five crop years. Producers with land having an established base and currently in the 10-year Conservation Reserve Program can add that land to the PFC when the CRP contract expires. A one-time sign-up period to cover the entire 7-year contracting period has been announced for May 20 through July 12. Because the contract payments add value to the land and can be transferred, all eligible land should be enrolled, regardless of whether or not the participant intends to accept the payments. Special provisions will accommodate the subsequent enrollment of land coming out of the CRP after July 12.

The Act establishes a $40,000 annual ceiling per participant for all PFC payments, adjustable up to $60,000 for participants with three or more eligible farms. For any participant, the payment for a given contract commodity (wheat, corn, sorghum, barley, oats, cotton, or rice) will be the product of 85 percent of their established base acres for that commodity, times their established yield per acre for that commodity, times the applicable payment rate per bushel or unit of production. The payment rate per acre will vary from one year to the next and will ultimately depend on final enrollment, subsequent withdrawals or CRP additions, and any supplemental funding made available through advance deficiency repayments. Some analysts have concluded the corn payment rate will average at least 36 cents per bushel over the seven-year contract period. Such a rate would be equivalent to more than 85 percent of the average of actual corn deficiency payment rates made over the last seven years, adjusted for the acreage set-aside requirements periodically imposed over those years.

For this fiscal year, roughly half of the contract payments can be received within 30 days of enrolling in the program, with the remainder paid out by September 30. For future fiscal years, participants can elect to receive half the payment in advance (either on December 15 or January 15) with the remainder at the end of the fiscal year (September 30). This schedule lumps all the fiscal 1996 payment and half the fiscal 1997 payment into the next few months. This initial lumping of payments at a time of high grain prices will present participants with some important decisions about allocating the added cash inflows between capital expenditures, savings, and debt paydown.

Selected measures defining CCC crop loan rates under the new legislation

	85% of 5-year average*	Maximum loan rate permitted	Stocks-to-use ratios that could lower rates	
			up to 5%	up to10 %
	($/bu.)	($/bu.)	(%)	(%)
Wheat	$2.82	$2.58	15 to 30	30 or more
Corn	$2.02	$1.89	12.5 to 25	25 or more
Soybeans	$4.97	$5.26	n.a.**	n.a.**

*Excludes the years with the high and low averages.

**Not applicable. The legislation sets the minimum CCC loan rate for soybeans at $4.92 per bushel.

Unlike past programs, the new contract payments impose only minimal crop and acreage restrictions on participants. So-called set-aside requirements that periodically mandated the idling of cropland under past programs have been eliminated. As such, participants have the option of planting all, some, or none of their base acres without jeopardizing their PFC payments. Similarly, the new planting flexibilities permit the participant to utilize their base acreage for virtually any crop—including hay and pasture, but excluding non-traditional plantings of fruits and vegetables. At the same time, however, participants must comply with all applicable conservation and wetland requirements and they must use their base acreage for agricultural purposes to insure the continuation of their contract payments.

In addition to the PFC payments, the new legislation extends the nonrecourse marketing assistance loan program—and related loan deficiency payments—administered by the Commodity Credit Corporation (CCC). This support mechanism is extended to any applicable loan commodity (wheat, corn and other feed grains, cotton, rice, soybeans, and other oilseeds) raised on land covered by a PFC, or any applicable oilseed production raised by any farmer. The program effectively provides a minimum price that a producer will receive for a loan commodity. Under this program, producers have the option of putting their eligible commodities under loan with the CCC at the established loan rate for that commodity. The commodity loan rate is basically defined as the average of the market prices received by farmers for that commodity in each of the last five years, excluding the high- and low-year average. The legislation stipulates a maximum CCC loan rate for corn of $1.89 a bushel and also gives the Secretary of Agriculture

the option of scaling down the loan rate whenever carryover stocks build up to more than 12.5 percent of annual use. A stocks-to-use ratio between 12.5 and 25 percent permits a cut of up to 5 percent. A ratio above 25 percent permits a cut of up to 10 percent in the formula CCC loan rate for corn. For soybeans, the same 5-year averaging formula is used to set the CCC loan rate, but the legislation establishes a rather narrow range of minimum and maximum rates ($4.92 to $5.26 per bushel).

Under the new legislation, the maturity of the CCC marketing assistance loans is limited to 9 or 10 months, with no provisions for extending the maturity. Interest rates charged on the loan will continue to be tied to the U.S. Treasury's cost of raising funds, but will be scaled 100 basis points (1 percentage point) above the interest rates charged previously. The producer has the option of repaying the loan in full, plus interest, or—if market prices for the commodity are below the loan rate—repaying the loan at the rate of the prevailing market price. Alternatively, if the market price is below the CCC loan rate, the producer can elect to forego the loan and instead simply accept a so-called loan deficiency payment. The loan deficiency payment rate per unit of commodity covered is simply the difference between the loan rate and the market price. All loan deficiency payments for any year are subject to a maximum of $75,000 per producer or—with multiple farms—up to $150,000.

Other features of the FAIR Act of 1996 that will at times provide some element of support to selected crops include the various provisions that continue to aid U.S. agricultural exports. The Export Enhancement Program (EEP) was scaled back in the new Act. The scaling back from past levels reflected both the view that large export subsidies were unwarranted in the near term while grain prices were at such unusually high levels and, for the outlying years, our commitments under the recently negotiated GATT agreement. Nevertheless, the new legislation authorizes up to nearly $3.2 billion to carry out the EEP over the next seven fiscal years. The upper limits on the annual amounts authorized range from $250 million in fiscal 1997 to $579 million in fiscal 2000. The Market Promotion Program—which helps promote U.S. foods in foreign countries—was renamed the Market Access Program and capped at $90 million annually. And finally, the Act extends the CCC's role in providing credit guarantees on financing arrangements covering U.S. agricultural exports. These so-called GSM-102 and GSM-103 credit guarantees were re-authorized for up to $5.5 billion in annual credit guarantees for each of the seven fiscal years covered by the new Act.

For dairy farmers, the new Act goes a long way in restructuring the current milk price support program. It establishes a four-year timetable for phasing out the current price support mechanism which utilizes CCC (government) purchases of manufactured dairy products to maintain a support (floor) price for the milk sold by farmers. The support price for milk with 3.67 percent butterfat is scaled downward over this four-year period, starting from the current $10.35 per hundredweight, to $10.20 in calendar 1997, $10.05 in 1998, and $9.90 in 1999.

Beginning in the year 2000, the program shifts from an orientation of providing a support price for milk to one of assisting processors to manage inventories of eligible dairy products. The CCC's support purchases of dairy products will end and be replaced with a recourse loan program to be made available to milk processors that make cheddar cheese, butter, and nonfat dry milk. The loan rates (the amount of loan funds which will be extended by the CCC per unit of eligible product) are to be established in a manner that will reflect an equivalent value of $9.90 per hundredweight for the milk. The loans to be extended to dairy processors will have an interest rate at least equal to the cost of the funds raised by the CCC through the U.S. Treasury. The original maturity of any such loans may not extend beyond the end of the fiscal year in which the loan was made. At that time—and at the discretion of the Secretary of Agriculture—the loans could be granted an extension of up to 12 months.

The forthcoming CCC dairy loan program will likely offer some seasonal support to milk prices when supplies exceed usage. However, it's not likely to be nearly as effective as the current program of dairy product purchases in maintaining a floor price during an extended period of imbalance between supply and demand. Unlike the program for extending CCC loans to grain farmers, the forthcoming dairy loan program will operate with recourse loans. Since recourse loans require repayment in full plus interest, they are of only limited value in establishing a floor price for a commodity. (Nonrecourse loans permit the transfer of the underlying commodity to the CCC as payment in full, a practice that historically was widely used in grains to isolate surplus stocks from commercial market channels and thus hold up market prices). Dairy farmers presently enjoy high milk prices as supplies remain in a relatively favorable balance with utilization. However, if the cyclical nature of the dairy industry swings to excess production over the next few years, the new support mechanism to come on stream in the year 2000 may prove a disappointment to many dairy farmers. To help guard against excess production, the new Act also authorized full funding of the Dairy Export Incentive Program (up to GATT limits) and offers other limited measures to promote dairy exports.

Gary L. Benjamin

SELECTED AGRICULTURAL ECONOMIC INDICATORS

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
Prices received by farmers *(index, 1990–92=100)*	March	108	1.9	9	3
Crops *(index, 1990–92=100)*	March	127	4.1	19	15
Corn *($ per bu.)*	March	3.54	5.0	54	29
Hay *($ per ton)*	March	83.40	2.7	0	–7
Soybeans *($ per bu.)*	March	6.97	–0.6	26	4
Wheat *($ per bu.)*	March	4.96	–0.6	41	34
Livestock and products *(index, 1990–92=100)*	March	94	1.1	1	–7
Barrows and gilts *($ per cwt.)*	March	49.20	4.0	29	10
Steers and heifers *($ per cwt.)*	March	60.40	–1.1	–14	–20
Milk *($ per cwt.)*	March	13.80	0.0	9	2
Eggs *(¢ per doz.)*	March	80.3	5.0	31	22
Consumer prices *(index, 1982–84=100)*	March	156	0.5	3	6
Food	March	152	0.5	3	6
Production or stocks					
Corn stocks *(mil. bu.)*	March 1	3,799	N.A.	–32	–5
Soybean stocks *(mil. bu.)*	March 1	1,190	N.A.	–13	16
Wheat stocks *(mil. bu.)*	March 1	826	N.A.	–15	–20
Beef production *(bil. lb.)*	February	2.05	–7.7	13	14
Pork production *(bil. lb.)*	February	1.42	–8.6	5	11
Milk production* *(bil. lb.)*	March	11.7	9.0	0	3
Receipts from farm marketings *(mil. dol.)*	December	16,881	–19.7	–4	–8
Crops**	December	10,159	–18.6	–4	8
Livestock	December	6,644	–17.1	2	–8
Government payments	December	78	–85.6	–83	–96
Agricultural exports *(mil. dol.)*	January	5,526	3.4	24	48
Corn *(mil. bu.)*	January	214	15.9	12	110
Soybeans *(mil. bu.)*	January	106	18.4	19	50
Wheat *(mil. bu.)*	January	97	–5.6	0	–16
Farm machinery sales *(units)*					
Tractors, over 40 HP	March	6,071	35.1	–4	–8
40 to 100 HP	March	3,442	42.2	5	3
100 HP or more	March	2,629	26.9	–14	–20
Combines	March	470	30.6	–11	–18

N.A. Not applicable
*22 selected states.
**Includes net CCC loans.

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