FARM PROGRAM CONFLICTS:
The $50,000 Case

by Carole Frank Nuckton

➢ Federal farm policy is replete with complex, conflicting objectives resulting from perpetually tinkering with a system established in the 1930s. The $50,000 limitation on deficiency payments to farmers illustrates one such conflict. Supply control under the acreage reduction plan won't work unless large growers participate. Attractive benefits, based on volume of production, encourage their participation, but the payment limitation thwarts it. Growers nearing the limit seek legal ways around it.

The government meets neither of its objectives with the limitation. It does not prevent large payments to some growers and it does not save money. It further complicates farm policy and adds substantial administrative costs for a program that doesn't work. And this is only one example. It is time to wipe the slate clean. Stop fixing yesterday (farm programs of the 1930s) and begin creating tomorrow by streamlining a farm policy that makes sense for the 1990s.

Policy tends to be backward looking—always trying to fix yesterday, rather than looking ahead to create tomorrow. The $50,000 farm commodity payment limitation is a case in point. It was added to farm legislation in 1970 to fix up two problems that had developed. It was aimed at reducing federal spending on farm programs and at preventing some farmers from receiving very large payments which seemed to some to be socially unjust.

A Brief Description

Since 1973, deficiency payments (the difference between the target price and the higher of the loan rate or the market price) have been one of the ways government has supported the incomes of farmers enrolled in commodity programs. Beginning in 1978, an acreage reduction plan (ARP) was added; deficiency payments were conditioned on farmers' agreeing to set aside a specified proportion of their land.

The law currently limits the deficiency payment to $50,000 per person. (A person is broadly defined as an individual, limited partnership, corporation, association, trust, estate, or other legal entity.) To make U.S. crops more competitive on world markets, the Food Security Act of 1985 (FSA-85) lowered the loan rate, while freezing target prices. Although in more recent years, the target prices have been gradually reduced. The lower loan rate, particularly in the early years of FSA-85, caused deficiency payments to be large for some producers.

Carole Frank Nuckton is Assistant to the Director of the University of California Agricultural Issues Center, located at UC Davis, and Technical Editor for the Giannini Foundation of Agricultural Economics. The topic was a special project while she was a 1989 Fellow at the National Center for Food and Agricultural Policy, Resources for the Future.

Conflicting Objectives

The $50,000 limitation on deficiency payments is but one example of conflicting objectives in federal farm programs. (The arguments about deficiency payment limitations apply as well to limits placed on other program payments whenever those limits constrain the achievement of specific program goals.)

If supply control under ARP is to be effective, large operators must be enrolled. However, because payments are based on volume of production, it seems that the payment limitation would discourage them from participating. If the payment limit were to *actually* discourage their participation, supply control would be much less effective. If the ARP were to be rendered ineffective by lack of large operators' participation, the volume marketed would rise, lowering market prices and increasing government outlays for deficiency payments to farmers.

In reality, however, most large operators find the programs so attractive that they seek legal ways around the payment limitations. With the help of lawyers and accountants, they reorganize their operations to attempt to earn what their volume of production would be worth without the limitation. The government incurs an additional administrative burden in approving or denying these plans and hearing appeals.

In turn most growers successfully avoid the payment limit. Thus, the payment limitation neither prevents large payments nor saves the government money. Neither of the payment limitation's original intents are met. The only gainers are the third parties—the lawyers and accountants.

Getting Around the Payment Limit

Consider, for example, a California rice grower farming 2,500 acres of rice. Just after the FSA-85, the 1986 deficiency payment to this farmer would be about $4.70 per cwt ($11.90 target price, less the $7.20 loan rate). Using the state's average yield of 70 cwt per acre, this farmer would receive $329 per acre in deficiency payments. In 1986, the set aside was 35 percent, so that our imagined rice farmer would plant 1,625 acres in rice and the farm would earn a total deficiency payment of $534,625—if there were no payment limit. But the $50,000 payment limit is reached with only 152 acres.

One hundred fifty-two acres is not an economic unit for California rice—for example, 97 percent of the state's rice crop is seeded by air. And much of the state's rice land is not suited for any other crop. With the help of a lawyer, this farmer "reorganizes" the farm. The goal is to add "persons" until payments nearly equal what this farm would have earned without the payment limit.

One popular way the lawyer might suggest would be the "Mississippi Christmas Tree." Persons are added, each eligible to receive payments up to the $50,000 limit. Suppose the rice farmer has a son and two daughters. The farm could be reorganized so that the father and each child receives $50,000 as individuals.

But six more legal entities could be created—a corporation for each combination of two—father, sons, and daughters: father-son, father-daughter 1, father-daughter 2, daughter 1-son, daughter 2-son, and daughter 1-daughter 2. Thus, this rice farmer family can legally receive deficiency payments of $500,000. Given our example, this number is still short of what the farm would have earned without the limit in effect. But the payments are presumably worth the lawyer's fee.

Other creative arrangements are legal. They include limited partnerships and various rental schemes.

New Rules in 1989

The press reported large farm payments informing the taxpaying public that the payment limitation policy was not working. Reports of foreigners receiving substantial U.S. commodity program payments added pressure on policymakers to fix "yesterday." In their undying attempt to "save the family farm" they sought to tighten up the rules. They had another go at "fixing up" farm programs.

The U.S. Department of Agriculture came up with proposed legislation to restrict payments—without giving up opportunities to control production with the ARP. The agricultural interests in Congress softened the proposal somewhat, but new, stricter rules came out in the Omnibus Reconciliation Act of 1987. There are three basic changes:

- Every producer—no matter what size payment earned—must be actively engaged in farming. To receive a payment, a person must make a significant contribution of capital, land, or equipment and labor or management.
- The number of direct or indirect entities (i.e., persons) through which an individual may earn payments, subject to the $50,000 ceiling, is limited to three. The California rice farmer in our example will have to find another way to organize.
- No payments will be made to nonresident aliens unless they contribute capital, land, and labor—the Prince of Liechtenstein provision.

Effect of New Rules

The motivation to avoid the payment limit has not changed. If the market price is below the loan rate in 1989, the number of acres that would generate a $50,000 deficiency payment for a California rice farm would be only 166 acres (target price $10.80, loan rate, $6.50). If the market price should be above the loan rate, the deficiency payment will be smaller, so the acreage that would earn the limit would be somewhat larger. The tightened restrictions mean that farmers must find new ways to maximize program benefits.

One scheme for our rice farmer might be to divide up the 2500 acres into 11 parcels of about 221 acres each. With the 1989 set-aside of 25 percent, each parcel could grow rice on 166 acres and earn a payment limit. If the farmer rents these 11 parcels to employees already actively engaged in farming, they will be contributing land and labor. The rent: $50,000 or $301 per acre. The new farmers receive the wages or salaries they would have received anyway.

The Need to Create Tomorrow

The conceptual formulation of the paradigm that society tends to fix yesterday rather than create tomorrow is laid out by Jerry L. Wade, in "Felt Needs and Anticipatory Needs: Reformulation of a Basic Community Development Principle," in the *Journal of the Community Development Society*, Spring 1989. Wade uses this visionary process in his workshops on rural community development. The need for a paradigm shift is just as great in the arena of federal farm programs.

It's Time

It is time to correct this inconsistency in federal farm policy. Either the payment limitations should be eliminated or the price-income support programs should be changed so that benefits are not based on volume of production.

Because most large operators obviously avoid the limit, the system does not save the government much money; and, therefore, government payments under the present program are approximately the same as they would be without the limitation. Even under the 1989 rules, farmers will find creative ways to reorganize until payments nearly equal what the farm would earn without the limit.

Eliminating the payment limitation would mean considerable savings in program administration costs, by simplifying and streamlining the system. Supply control could operate more effectively. County offices of the Agricultural Conservation and Stabilization Service would no longer have to judge the legitimacy of their neighbor's reorganization plans. And without the payment limit, farmers would save the large fees now paid to third parties.

Despite the logic for eliminating the payment limitation, it will likely remain entrenched as an integral, albeit conflicting, part of farm support programs.

The limit gives the "right" political signal in that it presents the perception that our legislators are for the American family farm—and against the large commercial agribusiness operations—although the reality is quite different. Besides, doing away with the limit would no doubt bring unwanted scrutiny upon the entire farm program.

Time to Create Tomorrow

The payment limitation policy is only one example of conflicting objectives built into federal farm programs. Policymakers continually look backward, "fixing up" the farm programs of the 1930s, trying to adapt them to the agriculture of the late 1980s. The result is inefficient, costly complexity, with multiple instruments working at cross purposes.

Again, take California rice growers, for example. They are offered a deficiency payment as long as they participate in ARP and meet other eligibility criteria (but the payments are limited). They are also offered a marketing "loan" whereby they can pay back their loan at the world price if it is lower than the loan rate. Marketing loans have two objectives: (1) to make rice "competitive" on world markets, i.e., subsidize exports to match the Thai price plus a premium for U.S. quality, and (2) to use up surplus Commodity Credit Corporation (CCC) stocks.

The second objective is intended to raise the domestic market price in order to decrease deficiency payments. However, CCC stocks were at zero in 1987/88 and 1988/89, while both the ARP and marketing loans continue for the 1989 crop. Finally, a large part of commodity payments are now off-budget, being made in generic PIK certificates which have created a new money market—and an opportunity for third party brokers, accountants, and speculators.

I conclude with two questions: Couldn't all this be simplified? Could we make an entirely new beginning with the 1990 farm bill—not looking back to fix up yesterday, but ahead to create tomorrow?