What Farm Managers Told Us about the 1996 Farm Act: Part 2

by Warren E. Johnston and Lyle P. Schertz

In the last issue of *Choices*, we reported our observations gained from written responses and discussions with panels of professional farm managers and operators regarding farm management decisions following the enactment of the 1996 Farm Act. There were eight panels nationwide chosen in major agricultural production areas thought to be particularly affected by provisions of the new legislation (the Plains States—North Dakota, Kansas, and Texas; the Midwest—Illinois and Ohio; the Mississippi Delta; southeastern Georgia: and a rice area of California). The panel discussions were the last stage of the information-gathering activity conducted mainly in the winter of 1997.

In our previous article we said that capitalization of the Production Flexibility Contract Payments (PFCPs) into land values and land rents was the important story about the 1996 Farm Act. We still think so. However, aside from the capitalization of the PFCPs our study also led us to three other conclusions:

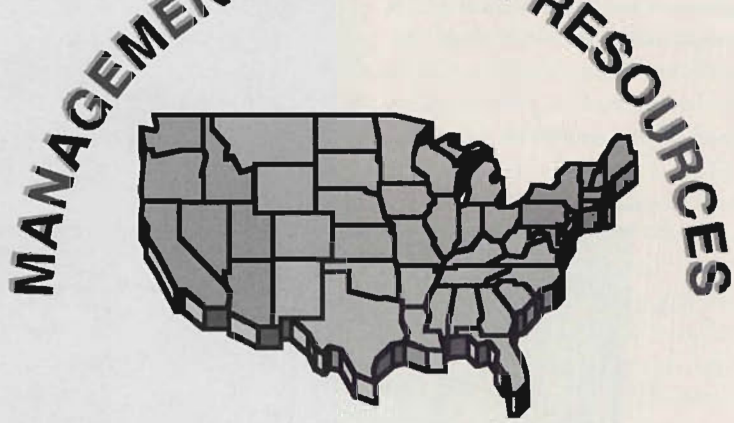
- The farm community likes the elimination of most planting restrictions, as well as the new payment system;
- PFCPs are not affecting directly how farm resources are being used; however, they may eventually have indirect effects on input management decisions; and
- Interest in marketing and managing price risk is very high and techniques for shifting risks are known or learnable, but knowing under what circumstances it is advantageous to shift risks is elusive.

This article focuses on each of these conclusions. In addition, we include a perspective about planting flexibility that has tremendous implications, we think, for the perennial question of payment limitations. In their rush to embrace flexibility the supporters of transfers to producers and land owners may have sown the seeds for effective payment limitations. At the very least, they certainly weakened their argument as to why payment limitations should not be instituted and made to work effectively.

Planting flexibility—embraced by all

The planting flexibility provision in the 1996 Farm Act provided the opportunity to base farm management decisions on expected crop profitability. Many operators did shift crop mixes, recognizing either new economic opportunities or more desirable rotations than those reflected in former historical crop bases.

The discussions with the farm management panelists confirmed that their clients—owners of farm land—like the elimination of planting restrictions.



Here are some things panelists said that illustrate the pervasive attitude on this topic:

- "Freedom to farm puts management to work."
- "Freedom to plant crops best suited for farming operation and strong commodity prices in 1996 allowed many operators to pay debt, expand their operations, upgrade equipment and perform improvement work on their farms."
- "Crop mix is now determined by resources, not USDA."

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PFCPs are not affecting current crop management decisions

There are two key questions related to PFCPs and farm management decisions. First, are PFCPs affecting crop mix or input application decisions? Our discussions with the panelists and economic reasoning lead us to conclude that the answer is no. The new planting flexibility provisions, together with expected yields, product prices, and crop growing costs, account for the changes that are occurring in crop mixes.

Second, might the PFCPs affect investment decisions? Discussions lead us to conclude that the answer to this question is "perhaps." There are two primary considerations: (1) higher land prices due in part to the PFCPs, and (2) increased income and associated wealth of land owners related to PFCPs. The enhanced land prices may, over time, stimulate producers to increase their use of non-land inputs such as machinery and chemicals. In that sense PFCPs may later affect management decisions via changes in land and variable input price ratios.

Further, panelists indicated that PFCP proceeds are being used for widely divergent purposes. Some of the farm managers indicated that they encourage their land-owning clients to make productivity-improving investments, in land leveling, irrigation, drainage systems, and other improvements. Various panelists also indicated that some recipients of PFCPs use the proceeds to purchase additional land and/or aggressively bid for additional rental acreage. There were no indications, however, that recipients are "banking" the PFCPs for use in years of depressed commodity prices or for a possible end to subsidies in 2003. This mix of responses suggests that investment decisions may be indirectly affected by the PFCPs.

Duncan Hood, PS International

The Illinois farm manager panel pose with Steve Halbrook, Warren Johnston, and Lyle Schertz after discussing the 1996 Farm Act effects on farm management decisions and their clients' responses to the act.

Panelists are concerned about marketing and price risks

Adjustments to the 1996 Farm Act go beyond production decisions such as changes in crop mixes. Panelists are seized with the importance of marketing and price risks to their clients and therefore to their businesses. The importance of marketing is reflected, for example, in the following statements made by panelists:

- "The two major changes are the open planting of acreages and changes in the market prices of commodities."
- "Greater adjustment of acreage and increased price volatility leads to need for more attention to marketing."
- "Farmers must concentrate on marketing for a huge part of their business if they plan to stay in business."
- "With loan rates frozen at current levels we expect increased price volatility."
- "Producers and land owners need to be focused on marketing. Marketing is much more critical to success in farming than ever before."

"Increasing risk" was identified by forty-one of sixty-two panelists as one of the "major changes that have occurred in the economic and financial setting for farming." Panelists widely believed that the 1996 Farm Act may lead to greater fluctuations of commodity prices than has occurred in recent years.

Farming interests continue to want government protection from low and declining prices but at the same time opportunities to realize benefits from rising prices. There is hope that (1) commodity selling programs can be designed to capture the higher prices for farmers/sellers and (2) government-sponsored insurance programs will make it possible to sharp-shoot situations where the combination of management decisions, crop prospects, and premium structures provide a high probability of net returns to those farmers/sellers.

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Panelists indicated much interest in revenue insurance. However, the amount of insurance demanded will depend substantially on lender requirements and on the extent that it is subsidized. For example, when asked if they would currently recommend buying unsubsidized crop insurance, many panelists indicated that they would not unless a lender required them to do so.

Consequently, we close with this thought. The planting flexibility of the 1996 Farm Act, which is popular today in the agricultural community almost as much as the PFCPs, reinforces arguments of those in Congress who advocate means testing of farm transfer payments.

Panel discussions revealed that the techniques (such as trading future contracts and options) for shifting price risks are widely known by producers and their advisers. However, they often do not know the market and personal financial conditions which make it advantageous to use these risk-shifting techniques. The distinction among different financial and market situations must be better understood if "managing price risk" activities are to be more than just another form of speculation.

Because the importance of marketing is so widely recognized, now may be the "teachable opportunity" for topics like speculation, risk transfer, and risk avoidance. It may also be the "commercial opportunity" to develop and promote risk transfer instruments. But that would be true only so long as the government, in spite of pressure from farm and nonfarm interest groups, avoids providing subsidies that undercut these risk transfer instruments.

A perspective on planting flexibility and payment limitations

We know of nobody who has made a connection between the new planting flexibility and arguments about limitations on payments to large operators and land owners. Nonetheless, we think that there is a connection, and that connection could have an important effect on the farm bill debates of 2002 and 2003.

In the past the most convincing argument against limiting payments was this: If payments were effectively limited, those whose payments were limited would not voluntarily cooperate in programs that restrict production. Without larger producers keeping land out of production, such programs would be ineffective in cutting production to increase farm commodity prices. But with the planting flexibility of the 1996 Farm Act there are no programs for keeping land out of production. The cooperation of the big landowners is no longer important for restraining production because restraining production is no longer on the agenda.

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Douglas Coulson, PS International

Delta farm manager panel recording how the 1996 Farm Act is affecting the management of Delta farm resources.

of farm transfer payments.

But let us hasten to add that two years after the passage of the 1996 Farm Act is not the time to predict legislative losses by commercial farm interests. After all, the Farm Act with its PFCPs was approved by the Congress and signed by the president in 1996, a year of avowed congressional and White House concern about the federal budget deficit. It was also the year the programs that transfer money to poor people were reformed. Clearly, those programs that transfer money to farm land owners have substantial political support.

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■ For more information

Reports related to the project reported on in this article are available online. The ERS staff report, Staff Paper No. AGES 9711, December 1997, *Managing Farm Resource in the Era of the 1996 Farm Act*, as well as manuscripts for each of the area panels and several appendices, are posted at the following URL: http://usdafarm.ucdavis.edu