



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Michigan State University, Dept of Agricultural Economics

PIK BIDS

By

Jim Hilker and Gerry Schwab

GIANNINI FOUNDATION OF
AGRICULTURAL ECONOMICS
LIBRARY

OCT 9 - 1984

I. Introduction

The USDA does not have enough grain in the CCC reserves to fulfill their PIK obligations. Therefore, they have asked for In-Kind compensation bids from holders of CCC loan corn--regular or reserve. This paper briefly explains the new program and shows how to calculate the consequences of alternative bids.

II. Explanation

In order to acquire more grain, the USDA is willing to forgive repayment of the loan and interest on CCC loan grain offered to it by April 15, 1983. It will also accept competitive bids from farmers who feel they need additional incentives to forfeit their loan grain. The USDA is offering two options under this program: (1) The "zero" bid option requires that all grain under loan be turned in and all of the loan and interest will be forgiven. Under this option, the USDA is committed to accept all grain offered, regardless of quantity. And, (2) allows the farmer to bid for a percent of the loan grain he wants to keep in return for turning in the balance covered by the loan to the USDA and have the loan and interest on the entire loan amount forgiven.

Pertinent points include:

- Only loan corn not needed to fulfill a farmer's PIK requirements can be offered to USDA.
- Once a bid is offered to USDA it cannot be withdrawn or modified even if it is still before April 15, 1983.
- It is open to everyone who has CCC loans, not just those in PIK.
- Do not have to enter any bid.
- USDA is not committed to taking bids over zero.
- The compensation grain is available to the farmer immediately to do with as he pleases.
- Only one bid can be given for each loan.
- CCC plans to notify by April 28 those producers whose bids are accepted.

- CCC will accept bids based on competitiveness, local need, class of grain offered, and location of loan grain offered.
- Will not accept grain placed in the farmer-owned reserve after January 11, 1983.
- Unused storage payments must be repaid (the prorated share of the 26.5¢ per year paid for storage under the FOR).
- Grain must be grade 3 or better.
- Farm stored loan grain acquired by the CCC must be delivered to a warehouse within 30 days.
- CCC will pay in-charges for forfeited loan grain.
- Farmer must pay for hauling to his regular delivery point. If USDA wants it hauled further, they will pay at the following rates:

<u>Miles</u>	<u>¢/Bu.</u>	<u>Miles</u>	<u>¢/Bu.</u>
5-19 -	6¢	90-99 -	18¢
20-39 -	8¢	100-129 -	19¢
40-49 -	10¢	130-149 -	20¢
50-59 -	12¢	150-169 -	22.5¢
60-69 -	14¢	170-179 -	24¢
70-79 -	15¢	180-190 -	26¢
80-89 -	16¢	191 & up -	27¢

III. Example

- Farmer has 10,000 bushels under FOR loan.
- Needs 5,000 bushels to fulfill PIK requirements on his farm.
 - If he entered a "zero" percent bid, he would turn in 5,000 bushels to CCC and be forgiven of his loan and interest.
 - If he were to bid 10 percent, and the bid was accepted, he would turn in 4,500 bushels. In return, his entire loan and interest would be forgiven and he still has 500 (10 percent of 5,000) bushels to sell at his discretion.

IV. Calculating Bids

- The problem will be approached in two manners. First, it will be shown what the equivalent market price would be given a bid and then what bid it would take to match a desired market price. There are two unknowns and, therefore, you cannot solve for one breakeven price.
- The formula below helps answer the question--given some percent bid, what would be the equivalent market price?

(Loan + interest due--unused storage payments + storage savings)
+ (% bid x market price May 1, 1983) = market price equivalent.

Example (10 percent bid):

- Loan (2.55 or 2.90) 2.90
- Interest due (6 months at 12 percent rate) +.174
- Unused storage payments

$$\frac{[26.5¢ * (12\text{-month remaining})]}{12}$$
 -.1325
- Storage cost you won't pay for 6 months (not including interest) +.06
- % bid times what you think market price will be May 1 (\$3.00 used here) +.30
- Market price equivalent (if zero bid, it would be \$3.00) 3.30
- This formula answers the question--what the bid should be to match a given market price. The market price here is what you think the price will be when you have to redeem the loan.

(Market price when loan is called) - (loan + interest due - unused storage payments + storage savings) = (% bid x market price as of May 1, 1983).

Example (\$3.15 market price):

- Market price at redemption 3.15
- Loan -2.90
- Interest due (6 months at 12 percent rate) -.174
- Unused storage payments (26.5¢ rate) +.1325
- Storage cost savings (6 months 1¢/month) -.06
- % bid times May 1 market price .15
 $.15 \div 3.00 = .05$

A 5 percent bid would equal a \$3.15 price at redemption.

V. Other Considerations

- Grain going out of condition.
- Need storage space.
- May generate extra cash if bid is accepted.

VI. Analysis

The decision is the trade-off between what your return would be now if you forfeited your loan grain under one of the two options, versus what it would be at loan redemption time or if triggered. Obviously, it is difficult to predict the prices needed to make the necessary calculations. Therefore, it is helpful to look at both the range and the most likely price of the two scenarios. In both cases, the price is bounded by the regular loan rate on the bottom side and the release price for the farmer-owned reserve on the top side. The 1981 reserve release level for corn is \$3.15 and \$3.25 for 1982 reserve corn. The price for corn in Michigan has reached as high as \$3.00 and may be an appropriate price most likely for May. However, if a lot of corn is released under this program, it could drive the price down significantly. The price is not likely to go over \$3.15 in Michigan in 1983-84 (marketing year); so if you have 1981 reserve corn, the price at redemption would probably be about \$3.15. And there is very little chance of prices hitting the 1982 release level of \$3.25, so corn under the 1982 reserve will probably not get the chance to be redeemed.