Special Article

Jack Harrison

Farm Act '96: Managing Farm Resources in a New Policy Environment

The 1996 Farm Act quickly and dramatically changed the decision-making environment for farm operators, landowners, and managers. The predictability of the Farm Act's production flexibility contract payments (PFCP's) and its almost complete elimination of planting restrictions challenged many farm operators and managers to rethink the way they manage their resources.

Uncertainty about the impact of such a major change in policy fostered interest in obtaining early indications of its effects on farm management decisions. A study funded by USDA's Economic Research Service brought together farm operators and managers on eight panels in several regions to discuss changes they had made or might make in farm management decisions following implementation of the 1996 Farm Act.

The swiftness of the program changes was of great significance to owner-operators, tenants, and landlords. Panelists indicated the new legislation's increased planting flexibility was not fully incorporated into 1996 farming decisions because of the late development of the farm bill. In many regions of the country, preliminary cropping plans, production financing, and even some plantings for the 1996 crop year were necessarily made before the farm bill was signed into law on April 4, 1996.

At the same time, the outlook for agriculture going into the 1996 crop year was very positive, making farm producers less reliant on traditional Federal farm programs. World farm commodity inventories were low, demand was strong, and prices were at decade-high levels for wheat, corn and other feed grains, and soybeans. The farm sector was more than a decade removed from the farm financial crisis of the 1980's and was in good financial health.

Yet in the limited number of decisions producers were called upon to make after the new farm act provisions were announced, producers did, in fact, respond to the new planting flexibility provisions which released them from base acreage requirements for specific crops. They also took advantage of the removal of annual acreage limitations, permitting additional acreage to be planted in the 1996 crop year.

As the year unfolded, sharp price falls revised farm decision makers' expectations for the year's profits. With a generally less optimistic outlook for 1997, farm managers and operators began to consider the implications of the 1996 Farm Act more closely, with increasing concern about commodity price volatility and the need for appropriate marketing and risk management strategies.

Overall, the panel discussions highlighted several effects of the new farm act that conductors of the study believe have particular relevance for the future of farm management decision making in the U.S.

- The new farm act's production flexibility contract payments and the elimination of most planting restrictions are popular with landowners, operators, and farm managers;
- the PFCP's are being capitalized into land values and are reflected in land rental rates; and
- farm managers and operators have an increased interest in strategies for marketing and for managing price risk.

Planting Flexibility Is Shaping Decisions

As expected, survey responses and discussions with panelists confirmed that farm owners, operators, and managers are favorable toward three particular features of the 1996 Farm Act: the predictability of program payments (PFCP's), which are no longer tied to farm prices; the unambiguous qualifications for PFCP's; and especially, the elimination of most planting restrictions. More than half of all panelists (58 percent) identified "elimination of planting restrictions" as a factor in their 1997 management decisions, and nearly half (45 percent) expected the same provisions to affect their decisions in 2000-02.

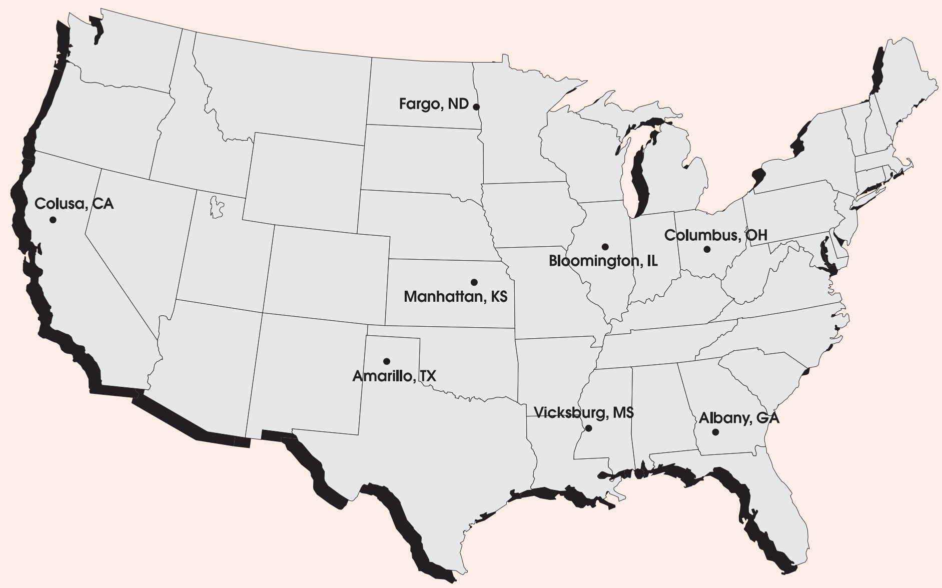
Panelists' own estimates of how they are adjusting crop mixes suggest that aggregated average data do not reflect the full potential benefits to individual farming operations associated

About the Study

To examine changes in the management of the nation's farm resources resulting from the 1996 Farm Act, USDA's Economic Research Service funded a study in early 1997, conducted with the support of the Farm Foundation, the University of California Agricultural Issues Center, and the American Society of Farm Managers and Rural Appraisers (ASFMRA). The study focused on "whole farm" decisions, as distinct from specific commodity decisions, examining potential effects of the 1996 Farm Act on the management of farm resources.

The study's approach was to conduct eight discussion panels located in several regions. Six panels were composed of professional farm managers and two of farm operators. Panel members were identified in consultation with ASFMRA state chapter leaders and with land-grant university faculty and extension staff members who had expertise in the study of farm management decisions. Areas were selected where farm programs were historically important to local economies. Panels were formed in North Dakota, Kansas, Texas, Illinois, Ohio, Georgia, Mississippi, and California.

Panels of Farm Managers and Operators Represented Eight Areas



The planned focus of the panel discussions was primarily on changes in the farm management decision environment, the mix of crops produced, responses to risks, landowner and operator lease arrangements, use of marketing information, and employment and economic activities in rural communities.

with planting flexibility. For example, Illinois panelists' expectations of the proportion of land they will devote to corn and soybeans were 45 and 43 percent on average for both 1997 and 2000-02—the same as for 1996. However, seven of the eight Illinois panelists expected that they would devote a different percentage of land to corn in 1997 than they had in 1996—three anticipated planting less and four anticipated planting more. Thus, aggregate statistics may obscure year-to-year changes at the individual farm level that balance out across all farms.

Panelists were alert to potential opportunities for growing nontraditional crops, those that have not often been grown on large acreages in the past. These farm managers and operators indicated they will shift land quickly to optimize their cropping mixes. They also appear willing to consider producing crops that have particular characteristics, like waxy and high-protein corn, and tofu soybeans, although the profitability of such crops will be watched closely. Whether the profitability of new crops will attract even modest acreages away from major program crops like corn, wheat, soybeans, cotton, and rice remains an open question.

PFCP's & Land Values

The demand for farmland has expanded recently in several areas of the country. Panel discussions in North Dakota, Illinois, Ohio, Georgia, and Mississippi in particular noted increases in land prices and cash rents. The land market in many areas had already been adjusting to higher commodity prices and to the optimism over future commodity exports when the new farm bill became law. The predictability of PFCP's became an additional, important impetus for increased demand for land.

The high degree of certainty attached to the PFCP's makes their valuation fundamentally different from the valuation of the price deficiency payments of the 1990 Farm Act. The amount and timing of income from PFCP's has been set through 2002. In contrast, the anticipated value of deficiency payments under the 1990 act was conditioned by commodity price expectations—high prices would lead to low (or no) deficiency payments, while low prices would precipitate high deficiency payments. Farm managers and operators could not be certain what their farm program income would be at the end of the current year, let alone in future years.

Special Article

As land prices rise relative to other input prices, economic reasoning suggests that land use will become more intensive, employing more nonland inputs per acre. Some panelists indicated, however, that nonland input prices are also increasing, which could keep the ratio of land prices to other input prices fairly constant and negate the effect of rising land prices and rental rates on farm management decision making.

The effect of the 1996 Farm Act on land markets may also be influencing how landowners and renters negotiate leases. Changes in underlying economic conditions do not normally warrant dramatic year-to-year changes in lease terms, but the potential for capitalization of PFCP's into farmland rents may affect the degree of adjustment owners and renters are prepared to consider. Panelists in most regions acknowledged tensions between landlords and tenants and serious reviews of traditional leasing arrangements.

In some cases, landowners appear to benefit almost exclusively from new rental conditions, which can include, depending on the type of lease, higher cash rents, higher landlord crop shares, and/or less landlord sharing of production expenses. In other areas, farm operators have been successful in seeking some protection from commodity price volatility by gaining higher levels of landlord risk sharing. Additionally, panelists acknowledged that the conditions of leases negotiated for the 1997 crop year were influenced by whether they were signed in early or late 1996, since crop price expectations dropped dramatically at midyear, changing the expected profits of landlords and renters.

Continued adjustments may be more problematic for crop-share leases than for cash leases. Panelists generally perceived that the intention of the 1996 Farm Act was that PFCP's attached to land leased on crop shares be divided between landowner and tenant, in the same proportions as the crop share called for in the lease. Thus, for landowners to receive more of the value of the PFCP's attached to their land, they must negotiate adjustments in crop-share leases. The simplest method is to change the crop share allotted to the landowner. An alternative is to change the sharing of input costs, such as the cost of fertilizer.

Panelists indicated that some landowners are simply discontinuing the renting of their farmland in order to "capture" the full value of PFCP's. Instead of renting their land, these landowners are turning to custom services to operate their farms. They pay operators (sometimes the same person who had previously been a share tenant) to perform needed field work, and pay input suppliers to make the appropriate applications of fertilizers and pesticides.

According to panelists, not all landowners are changing rental rates or crop-share leases to reflect the value of PFCP's attached to their land. Some may be unaware of the additional value the PFCP's bring to their land. Others may have personal or long-term relationships with tenants that would make such lease changes inappropriate. Still others may find that a lack of competition for land in local rental markets precludes their renegotiating more advantageous leases.

Farm Act May Lead to . . .

Pronounced Change in Some Areas of Management . . .

Management changes	Panelists expecting pronounced changes
	Percent
More attention to marketing and risk management	31
Greater adjustment of acreage among crops	25
Use of new technologies	16
Higher land values and rents	13
Changes in production practices	5
More competition among renters	3

Farm manager and farm operator responses to the question: "What three changes in the management of farm resources on the acreage you manage do you expect to be the most pronounced in the next 5 years?"

. . . and Lasting Change in the Operating Environment

Changes in economic environment	Panelists expecting changes to endure
	Percent
Increased risk	31
Program changes	23
Increased importance of marketing	22
Higher land values and rents	10
Lower commodity prices	7

Farm manager and farm operator responses to the question: "What three changes in the economic and financial setting for farming are most likely to endure until 2000-2002?"

Whether landowners renegotiate leases or otherwise take advantage of increases in the value of their land, the initiation of PFCP's has increased the wealth of those who own land. Panelists indicated that PFCP's are being used by landowners for widely divergent purposes.

Recipients' use of PFCP's does not appear to be guided by a belief that transfer payments will disappear in 2003 or that PFCP's should be "banked" for use in years of depressed commodity prices. Some farm manager panelists indicated they encourage their clients (owners) to use PFCP's to make productivity-improving investments, such as land leveling and installing irrigation and drainage systems. Other panelists, however, indicated that some recipients of PFCP's are using the proceeds to purchase additional land or aggressively bid for additional rental acreage.

Marketing & Risk Management In Sharper Focus

The 1996 Farm Act program changes have affected farm management beyond simply broadening options such as which crop mix to adopt. Panelists recognized the increased importance of marketing and its relationship to price risks. Forty-one panelists identified "increasing risks" as one of the "major changes that have occurred in the economic and financial setting for farming" on the survey administered for this study. Panel discussions indicated a widespread belief that the 1996 Farm Act may lead to greater fluctuation in commodity prices than has occurred in recent years.

Panelists expressed a high level of interest in revenue insurance, but the amount of insurance will likely depend on the extent to which lenders require such coverage and the amount of subsidy offered to producers. For example, when asked if they would favor buying crop insurance if it were not subsidized, many panelists indicated that unless a lender required them to do so, they would not.

Because the importance of risk management is currently widely recognized, now may be the "teachable moment" for introducing risk management topics like speculation, risk transfer, and risk avoidance to farm managers and operators. It may also be the "commercial opportunity" to develop and promote private-sector risk transfer instruments.

Farming interests understandably desire protection from low and declining prices without restricting their opportunity to gain individual profits from rising prices. Farm managers and operators expect to design marketing strategies that will capture high prices, while continuing to take selective advantage of government-sponsored crop insurance programs when these provide a high probability of net positive payouts.

Although the study of farm operators and managers contributes important insights about current and prospective effects of the 1996 Farm Act, much more information needs to be collected and analyzed to fully understand its implications. For example, it is not yet evident what will be the economic and distribution effects of the income streams and wealth associated with PFCP's. Similarly, questions about the effects of attaching program benefits to land and making them transferable require careful analysis. Farm management decision makers, analysts, policy makers, and the public will continue to follow these issues, as experience with the provisions of the 1996 Farm Act grows.

Lyle P. Schertz, ERS Cooperator (540) 636-8919 and Warren E. Johnston, University of California-Davis (916) 756-0870
lrschert@rma.edu
wejohnston@ucdavis.edu AO

Upcoming Reports—
USDA's Economic Research Service

The following reports will be issued electronically on dates and at times (ET) indicated.

August

*13 Cotton & Wool Outlook (4 pm)***
*Feed Outlook (4 pm)***
*Oil Crops Outlook (4 pm)***
*Rice Outlook (4 pm)***
*Wheat (4 pm)***
15 Livestock, Dairy, & Poultry (12 noon)
*20 Agricultural Outlook**
*21 Fruit & Tree Nuts**
*22 U.S. Agricultural Trade Update**
*26 APEC**
*28 Agricultural Exports**

*Release of summary, 3 pm.
**Available electronically only.