Sectorwide Impacts Mixed

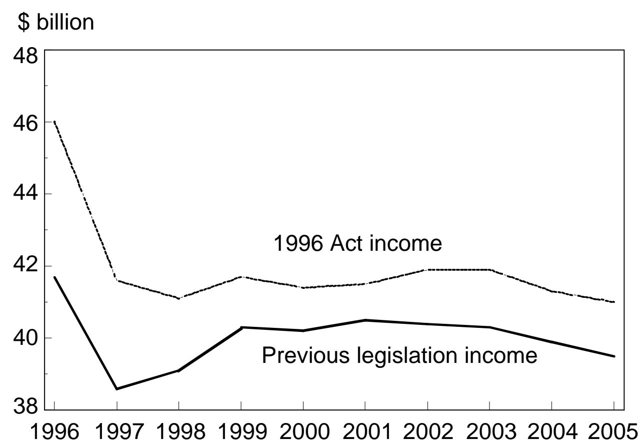
Higher Government Payments Increase Net Farm Income

Net farm income is expected to be somewhat higher under the 1996 Act than projected under a continuation of previous agricultural law (fig. 8). This largely reflects higher government payments to farmers as production flexibility contract payments exceed projected deficiency payments under prior farm law (fig. 9). Changes in the timing of payments to farmers will provide an additional boost to farm income in the first year of the program—pushing 1996 net incomes up about $4 billion. The rise in net farm income, however, will be less than the increase in government payments. Lower net farm incomes for dairy and peanut producers and higher production expenses will partly offset higher government payments. Dairy sector cash receipts will be lower under the 1996 Act due to the phase-out of price supports, but dairy net income reductions will be smaller because the elimination of the dairy assessment will be a partial offset. Peanut receipts will also drop, reflecting the lower marketings eligible for quota support and reduced quota price supports. Production expenses will rise mostly due to increased rents to nonoperator landlords, reflecting the landlord share of higher government payments.

Adjustments in rental and lease arrangements likely will alter individual producer returns. When new or updated rental arrangements are negotiated, some landowners may demand rents of at least the full value of production flexibility contract payments, since the land may be idled in a conserving use with the landowner eligible to receive the full production flexibility contract payment. However, as long as the land can provide additional net returns, it is likely to remain in production.

Figure 8

Net farm income higher as 1996 Act contract payments exceed projected deficiency payments under previous legislation

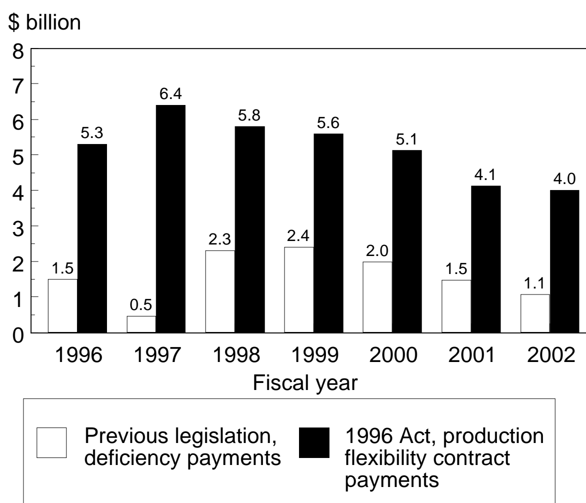


Net farm income projections under the 1996 Act assume that production flexibility contract payments continue after 2002.

Compiled by Economic Research Service, USDA.

Figure 9

Production flexibility contract payments exceed projected deficiency payments



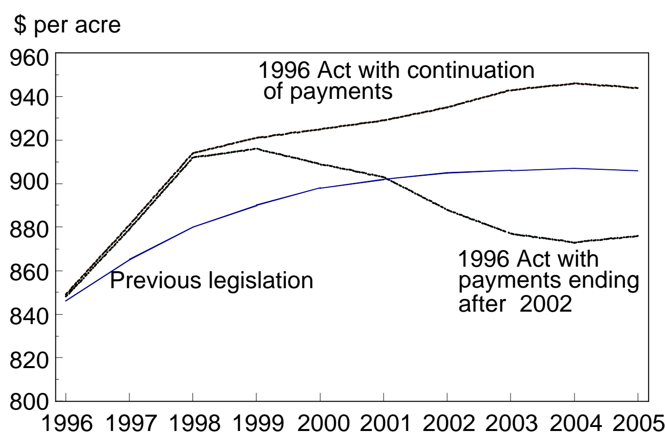
Compiled by Economic Research Service, USDA.

Farmers will continue to make adjustments in moving to a market economy under the new farm legislation. Relative market prices will become more important in determining cropping practices. The effects of market risk on net farm income increase under the 1996 Act. Net farm income will be potentially more variable because government payments are no longer linked to market prices. Loan rates, which remain but at relatively low levels (fig. 3), continue to provide some income protection. To counter potentially greater income volatility, many farmers will give increased attention to risk management when making production and marketing decisions. Many farmers will refine or develop new skills in the use of futures and options markets, forward contracting, and other marketing arrangements.

Farmland Values Reflect Higher Government Payments

Farmland values will be higher, reflecting the capitalization of larger expected total returns to the land (fig. 10). Increased variability in net returns could also affect farmland values, although the effects

Figure 10
Farmland values depend on expectations of future program payments



Source: Economic Research Service, USDA.

of nonagricultural factors such as urban pressure on farmland values could mitigate the adjustments. Producers' expectations regarding farm income will adjust quickly to the new farm law, so most adjustments in farmland values will occur in the initial years.

Expectations of future farm programs after 2002 will increasingly affect farmland values. If commodity income support payments continue beyond 2002, farm income and farmland values will be enhanced. However, if payments are eliminated or greatly reduced beyond 2002, net farm income would decline and farmland values would fall.

Farm Financial Conditions Improve

Increases in farm income under provisions of the 1996 Act will improve the financial viability of many individual farmers. However, farmers who produce commodities where government support is reduced, such as dairy, rice, and peanuts, may change their farm operations to limit impacts on their financial conditions.

Relatively high commodity prices combined with higher government payments during the initial years under the 1996 Act will provide an opportunity for farmers who receive production flexibility contract payments to improve their longer term financial conditions through debt repayment, investment in improved production equipment and technologies, and establishment of cash reserves.

Higher farmland values will enhance farmers' ability to obtain credit. The farm business debt-to-asset ratio was projected at about 15 percent in 2002 with a continuation of previous legislation. This ratio should improve under the 1996 Act. The debt-to-asset ratio will remain well below the 1985 high of 23 percent. Increased income variability will somewhat reduce farmers' creditworthiness. Credit availability, however, should not be a significant problem.

Despite overall improved farm income, some producers will leave the sector. Among farms that remain financially viable, there will be continued pressure to (1) increase the size of farm operations as a means of increasing farm income, or (2) reduce the size of farm operations so that labor can be allocated to off-farm opportunities. These factors will continue the longrun trend of farm consolidation, as larger more efficient producers acquire assets of marginal farms. The productive assets will likely remain in the agricultural sector.

Regional Impacts Vary

Participation in farm commodity programs and the relative profitability of farming vary from one region to another. Areas with production concentrated in commodities such as dairy, rice, and peanuts may face greater adjustments than other regions. Also, farmers in regions with higher dependence on production of crops eligible for contract payments under the 1996 Act will face adjustments of moving more fully to market orientation. Multiple-cropping opportunities available in some regions may ease adjustments for some farmers.

Regional impacts on farm income will in part reflect the distribution of production flexibility contract payments. Regional adjustments in farmland values will reflect regional variation in net incomes, as well as the relative importance of agricultural and nonagricultural returns in the determination of farmland values.

Environmental Impacts Mixed

Environmental programs are more targeted under the 1996 Act, which should lead to improved effectiveness. Additionally, more farmers are expected to sign production flexibility contracts than typically participated in annual commodity programs in the past, increasing the land covered by conservation compliance. Elimination of nearly all planting restrictions under the 1996 Act will permit farmers to adopt more crop rotations, which can benefit the environment as well as present opportunities for longer term gains in productivity.

With elimination of planting restrictions, planted area is likely to be higher during periods of large supplies than it would have been if ARP's had been implemented. Soil erosion and chemical runoff are generally higher with increased planted area. Per-acre soil and chemical runoff losses may be higher as more marginal acreage is brought into production.

Total CRP enrollment is expected to be similar to that projected under previous legislation. However, increased enrollment of more environmentally sensitive cropland in the CRP results from use of higher environmental criteria for new or extended contracts. This will shift enrollment toward regions with water quality problems, such as the Corn Belt, and likely will include more land that had been planted to corn and soybeans. Declines in CRP acreage in the Northern Plains States may reduce benefits associated with protection of threatened wildlife populations.

Government Outlays Increase

Government income support payments for major field crops will decline under the 1996 Act compared with historical levels of deficiency payments. However, production flexibility contract payments will be greater than projected deficiency payments would have been (fig. 9).

Under the 1996 Act, maximum EEP expenditures in 1996 through 1999 total $1.65 billion, about half of the Uruguay Round limits. Dairy program costs will be cut as dairy price supports are phased down from 1996 through 1999 and terminated thereafter. Costs of the peanut program will drop. The 1996 Act increases sugar marketing assessments, which will increase Federal revenues.

Retail Food Prices Largely Unchanged

Consumer food prices will be marginally lower under the 1996 Act. Retail prices for dairy products will average about 1 percent lower. Prices for peanuts and peanut products will be slightly lower, while consumer rice prices will be higher. Prices for other grains and oilseeds will be essentially unchanged, as will grain-based food prices, such as meats, cereals, and bakery products.

Increased Role for Marketplace to Manage Volatility Under the 1996 Act

Historically, agricultural markets have been variable as weather conditions vary and as policies and economic conditions change around the world. As market conditions vary, an important difference with the new farm program is that market forces will primarily determine supply, use, and prices, with minimal influence from government programs.

1996 Act Transfers Income Variability Risk from Government to Farmers. When agricultural surpluses occurred in the past, government programs tempered price and income adjustments. When prices fell, deficiency payments increased, providing some income stability to farmers. Market income risk due to price variability was partially carried by the Government and deficiency payments varied from year to year.

In contrast, under the 1996 Act, production flexibility contract payments remain fixed regardless of market prices. As a result, the Government carries little risk while farmers in general will face greater risk of income volatility, reflecting market price variation more directly.[4]

Marketing loan programs for rice, cotton, oilseeds, wheat, and feed grains continue in the new farm law, allowing repayment of commodity loans at less than the loan rate. However, loan rates for wheat, feed grains, and cotton under the 1996 Act are lower than would likely have occurred with extension of previous legislation, and world rice prices are higher. Thus, marketing loan benefits to farmers will be less likely to occur for these crops, shifting more price and income risk to farmers and reducing potential government costs.

Marketing Alternatives Available for Farmers to Manage Risk. To manage the risk shifted to farmers, some contract crop producers are likely to consider marketing alternatives to offset a portion of the potentially higher income variability. Previously, a portion of this risk was managed through deficiency payments. Individual farmers will develop a risk management strategy best suited for their farms (see box, "Farm strategies to manage risk"). Some farmers will expand their use of futures and options markets, possibly using new instruments such as yield contracts. Others will alter their marketing practices either by increasing storage to take advantage of higher prices during the marketing year or in

[4] There can be exceptions for individual farmers, such as a producer whose crops failed during high-priced years. Without a crop, this farmer will have no market receipts from crop sales. Under past legislation, crop insurance payments would have partly offset the loss, but deficiency payments would have been low, leaving the farmer with low farm income. Under the 1996 Act, the fixed production flexibility contract payments would tend to stabilize this farmer's income.

subsequent years, or by contracting in advance for the sale of their commodity. Around 10 percent of grain farmers typically use production and marketing contracts, compared with over 90 percent of broiler producers. Other alternatives include integrated ownership and involvement with more value-added processing beyond the farmgate. Finally, some producers will accept the risk and elect not to change their production and marketing strategies.

Production flexibility contract payments combined with strong farm prices during the next few years will provide farmers with the opportunity to reduce debt and to increase equity to mitigate potential income volatility. Even though the 1996 Act does not require producers to purchase crop insurance, many producers are expected to continue to use crop insurance for yield protection and to possibly expand coverage using newly available revenue insurance options.

Planting flexibility under the 1996 Act will permit farmers to alter their production practices to reduce risk. Some field crop producers are expected to look for ways to diversify their production practices under the 1996 Act. For example, some Northern Plains wheat acreage could move to other crops such as minor oilseeds and sugarbeets to diversify production and to include more fallow in crop rotations. Additionally, some Corn Belt land could shift from corn to soybeans in increased use of crop rotations. Such shifts serve as risk management tools and as means of increasing longer term productivity.

Alternatively, some producers may elect to intensify their farm operations by producing fewer crops best suited for their land. Potential volatility could then be addressed through the use of commercial risk management instruments such as crop insurance and marketing options shown in the box, "Farm strategies to manage risk."

Selection of appropriate production and risk management strategies will likely alter the information, analytical, and education needs of farmers. Farmers will select the appropriate strategies to improve farm production efficiency, risk management, and marketing based on cost-benefit analyses of various alternatives using market and other information. Some farmers will rely more heavily on analyses reported in trade journals and through the Extension Service, while others will conduct their own analyses. Many farmers are already involved in these types of activities, but the 1996 Act should accelerate the process and increase the importance of sound farm-level decisionmaking.

Farm strategies to manage risk

- Hedge or use futures markets
- Forward-contract crop sales
- Spread sales out over the year or across years
- Reduce debt/increase savings and equity
- Produce commodities with less variable yields, prices, and income
- Diversify production
- Integrate ownership
- Purchase crop and/or revenue insurance
- Add value beyond farmgate
- Use market information and analysis
- Increase education