

# FAPRI Bulletin

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## The Loan Deficiency Payment Phenomenon

The extremely low prices farmers have experienced this summer and fall have triggered a relatively little known program within the Federal Agricultural Improvement and Reform Act of 1996 (otherwise known as the 1996 Farm Bill or the FAIR Act). The loan deficiency payment (LDP) program is embedded in the nonrecourse marketing assistance loan program that exists for 16 crops. This program provides producers with financial tools to alleviate possible short-term cash flow needs without selling their crop, thus allowing farmers to store production and market their crops when conditions are more favorable.

When producers enter the program, they can choose to receive a loan against their crop, or if prices are low, they can choose to be paid an LDP instead of taking out a loan. The LDPs are direct payments to farmers that do not have to be repaid. The LDP rates change daily and are determined for each county and crop according to loan rates and calculated posted county prices (PCPs). If the loan rate is above the PCP, producers are eligible for LDPs, and the LDP rate is the difference between the loan rate and the PCP. County loan rates are based on the national loan rate, a 12-month average PCP, production data, and the distance to terminal markets. The PCP is a price formulated to mimic crop marketing conditions in the county and is based on terminal market prices, adjustments reflecting market and transportation factors.

Historically, the LDP portion of the loan programs has rarely been in effect. Prices have stayed above the LDP trigger levels. In 1995 and 1996, no loan deficiency payments were made. In 1997, LDPs were available for wheat, barley, oats, and upland cotton. Producers received just more than \$2 million with the vast majority going to cotton producers. However, the recent price changes for crops this summer and fall have opened the LDP provisions to producers of at least 10 commodities, and farmers have taken advantage of this opportunity. Table 1 shows the quantities on which LDPs have been paid, the dollar amount of these payments, and the average rate per unit.

The LDP amount for oats alone is nearly five times the total amount paid through LDPs for 1995-97 for all crops combined. Wheat, corn, and soybean producers have received the lion's share of this year's LDPs. More than half of the wheat crop was placed in the LDP program. The total payouts under the LDP provisions have reached more than \$1 billion

and continue to increase. (Data in Table 1 are preliminary since producers have several more months in which they can take advantage of this program if prices remain low enough.)

Based on the latest national crop estimates, nearly half of the U.S. wheat crop has entered the LDP program.

Table 1. 1998 LDP National Figures as of November 12, 1998

Commodity	Quantity	Payments	Rate per Unit
	(mill. bu.)	(\$ mill.)	(\$/bu.)
Wheat	1,278	375	0.29
Corn	1,314	325	0.25
Barley	205	62	0.30
Oats	56	10	0.19
Soybean	686	300	0.44
Sorghum	101	24	0.43
	(thou. bales)		(\$/bale)
Upland Cotton	644	15	22.66
Others		11	
Total		1,123	

Table 2. Possible Effects of Removing Loan Rate Caps

Commodity	Payments	Increase over actual	Rate per unit	Increase over actual
	(\$ mill.)		(\$/bu.)	
Wheat	1,129	754	0.88	0.59
Corn	706	381	0.54	0.29
Barley	159	97	0.77	0.47
Oats	22	11	0.39	0.20
Soybean	513	213	0.75	0.31
Sorghum	46	22	0.82	0.39
			(\$/bale)	
Upland Cotton	37	23	58.13	35.47

Barley producers have enrolled 57 percent of the 1998 crop. One-third of the oat crop has been placed in the LDP program. For corn and soybeans, the percentages of the 1998 crop in the LDP program are 13 and 25 percent, respectively. Cotton producers have placed only 0.5 percent of the 1998 cotton crop in the program, while sorghum producers have placed 19 percent.

Earlier this fall, policymakers in Washington debated the merits of removing the cap on national crop loan rates. Under the FAIR Act most commodity loan rates are capped at the 1995 crop year loan rate. If this proposal had passed and been applied to the 1998 crop, it would have had a significant effect on LDPs. Estimated effects are shown in Table 2. It is assumed that producers would have the same choices between the commodity loan and the LDP.

Under the loan rate cap removal, LDPs for the seven crops listed in Table 2 would have increased by \$1.5 billion. Wheat farmers would have been the biggest beneficiaries of this change, receiving half of the increase. Wheat LDP amounts would have tripled. The other crops also gain significantly, from 1.7 times the actual amount for soybeans to 2.6 times the actual amount for upland cotton.

Current LDP price figures are available on CARD's web site [www.card.iastate.edu](http://www.card.iastate.edu).

Note: Data for Table 1 can be obtained from the on-line report page on the USDA Web page: [www.fsa.usda.gov/dafp/psd/reports.htm](http://www.fsa.usda.gov/dafp/psd/reports.htm).

## Government Payments to Supplement Farm Income

On October 21, after much debate and political wrangling, Congress passed and

the President signed into law the \$500 billion Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999. Central to the budget debate: how to help US farmers during a time of economic stress due to crop disasters and low commodity prices. Producers were and are faced with a

substantial drop in net farm income as a result of the aforementioned problems. In response to this year's agricultural woes, FAPRI computed a September baseline for U.S. agriculture. This baseline shows net farm income dropping from \$49.88 billion in 1997 to an estimated \$44.24 billion in 1998 and to an even lower projection of \$43.38 billion in 1999. That's a decline of 11 percent and 13 percent when compared to 1997 income. However, it is only 4.33 percent below the 5-year average from 1993-1997.

Congress sensed an impending peril in farm country and provided nearly \$6 billion in an aid package for U.S. producers imbedded in the Omnibus-spending bill. The bulk for this amount, \$2.8 billion, will be in the form of direct payments automatically sent to producers who were eligible under the 1996 Farm Bill to receive 1998 Production Flexibility Contract (PFC) Payments. Producers began receiving those payments in November 1998, and the amounts should be around 49.72 percent of their 1998 contract payment. On a per bushel basis, this amounts to approximately \$.19 for contract corn, \$.33 for wheat, and \$.23 for

sorghum. Payments for other crops include \$.035 per pound for cotton and \$1.46 per hundredweight for rice. This payment is in no way related to the 1998 Emergency Farm Financial Relief Act, which allows farmers the flexibility to decide when and how they want to take their 1999 PFC payment. They have

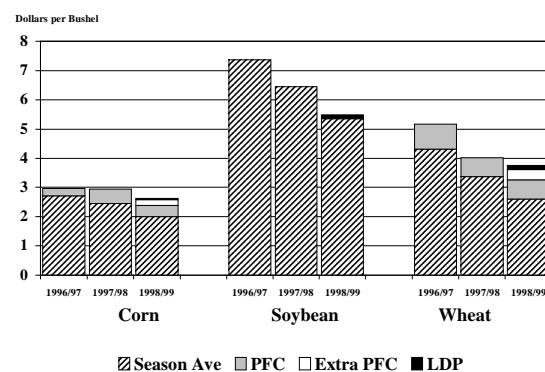
opportunity to take the payment in December of 1998 or during 1999 and in one lump sum or in two equal installments.

Other allocations of the \$6 billion Aid Package include:

- \$200 million in assistance to dairy producers. Distribution will be determined through a formula yet to be determined and could provide \$.12 per hundredweight.
- \$1.5 billion for single-year disaster. This is set aside specifically for crop losses in 1998.
- \$875 million for multi-year disasters. This was established primarily for Northern and Southern Plains producers who have suffered production problems, either weather or disease related, during successive years (three of the last five).
- \$200 million in livestock feed assistance, which provides cost share assistance to livestock producers who lost 1998 feed supplies to disaster.
- Permanent income averaging. This will help spread producers income tax burden over several years.
- Changes in health insurance deductibility for the self-employed. Presently, deductibility is 45 percent. It increases to 60 percent in 1999, 70 percent in 2002, and to 100 percent in 2003.
- Net operation loss carryback. Farmers can carryback a net loss for up to five years and receive a tax refund.
- Farmers will not have to pay taxes on contract payments until they are actually received.
- Fuel use credits for biodiesel.

Farmers are also eligible under the 1996 Farm Bill to claim loan deficiency payments (LDP) when commodity prices fall below established levels. The LDPs vary day to day and county to county, but producers have been very active in taking advantage

Figure 1. Crop Prices and Government Payments



of this program this year. LDPs for this year's crop can be taken anytime between the harvest of the crop and next May, as long as the producer still has control. Also, for this year, producers who harvested feed grains in forms other than whole kernel are eligible.

Figure 1 shows the crop prices received during the past two crop years including the PFC payment. It also shows FAPRI projections for the 1998/99 crop, including PFC payments, additional PFC payments and the estimated season LDP average. With the additional government assistance the amount received for corn and wheat is still below what producers received for the 1997/98 crops. However, without these additional sources of income the effects of the decline in cash prices would be much greater. Soybean prices are harder hit because they are not eligible under the Farm Bill for program payments but are eligible for LDPs.

The government payments will be a shot in the arm to those in farm country as they head into 1999. The tax adjustments should provide more long-term benefits for producers by allowing them to average out the fluctuations in income that occur in agriculture. •

## Argentine Cattle-Beef Sector Poised to Recover Glory Days

Argentina has been an important player in the world beef market for many years and will continue to be a significant player in the future. It ranks fourth in its share of total world beef exports at 7.36 percent, following Australia at 21.95 percent, the European Union at 19.79 percent, and the United States at 14.63 percent.

The world beef trade is segmented between foot and mouth (FMD) endemic countries (i.e., Atlantic beef market) and non-FMD endemic countries (i.e., Pacific beef market). Australia, United States, Canada, and New Zealand are the major exporters in the Pacific market, while Argentina ranks second to the EU in the Atlantic market. However, because the EU is effectively constrained by a GATT limit in its exports Argentina is well positioned to be the main exporter of beef in the Atlantic market in the short-run. Moreover, its presence will be increasingly felt in the Pacific market in the mid to the long-run.

Argentina's cattle-beef sector is firmly anchored on sound fundamentals with its historical comparative advantage in beef largely a product of its rich resource endowments. Of its 2.8 million square kilometer area, 10 percent is under permanent pastures. Although its current beef production is mostly pasture-based, Argentina is a leading producer of most of the feed grains, which would allow it to engage in the production of grain-fed beef if it gains access to markets where this product is preferred.

During its glory days in the late 1960s to 1970s, Argentina's cattle inventory peaked at 61.5 million head and beef export reached 775 thousand metric tons (tmt). However, a combination of factors led to a sustained stock liquidation process starting in 1988, which has reduced the cattle stock to the present number of 50.3 million head and almost cut into half its export level to 420 tmt. This liquidation is strongly evidenced by the continuous liquidation of beef cows throughout a 12-year period. Prior to 1988, the proportion of cow slaughter relative to total slaughter was only around 25 percent. This increased significantly by 8 percentage points in 1988 and has remained at a high level, reaching an average of 33 percent in the last decade.

The economic crisis faced in the late 1980s to early 1990s that brought high inflation to 5,000 percent and high interest rates to 524 percent adversely affected Argentina's cattle-beef sector, initiating the prolonged downward slide in its cattle inventory. Profitability in beef production was squeezed out, discouraging any investments for expansion. At the time when macroeconomic reforms began to stabilize the economy in 1995, the world beef market was hit by the BSE (bovine spongiform encephalopathy) crisis in the EU - the United Kingdom in particular - which further depressed prices in 1995 at the time when the world beef price was already in its declining phase. Although BSE may have provided temporary markets for Argentina when exports from some members of the EU were banned, expanding its exports from 376 tmt in 1994 to 520 tmt in 1995, it actually contributed to the further decline of the cattle stock since a large proportion of the slaughtered animals in 1995 were beef cows. The share of beef cow

slaughter to total slaughter was pushed to its highest level since the 1960s at 35 percent. Then a severe drought in 1995 and 1996 reduced the calving rate. Compounding these problems were the high grain and oilseed prices in 1996, which displaced cattle operation to marginal areas as some pastureland was brought to crop production.

A combination of factors including some stability in its domestic economy, an increasingly liberalized meat trade, successes in its animal sanitation initiatives, and the proven resiliency of the Argentine meat industry is providing the needed engine for recovery and creating a greater sense of optimism on its short-term and medium term prospects. The most recent numbers in 1998 suggest strong signs of recovery. The downward phase of the cattle cycle that began in 1993 seems to have bottomed in 1997. Although still high, the proportion of beef cow slaughter has been declining since 1995, and beef cow numbers showed a modest increase of 0.952 percent in 1998. Moreover, there is strong evidence to believe that this turnaround is not just the upward phase of a cattle cycle, but more so a structural reversal of the long-term downward trend experienced by the cattle-beef sector in the last two decades.

The seeds of the recovery were sown many years ago. Its stable economy with sustained growth, the primary driver of this recovery, is a product of the macroeconomic structural reforms introduced in the mid 1980s to the early 1990s in response to its economic problem during this period. The key initiative was the 1991 Convertibility Law, which pegged the peso to the dollar and banned the printing of unbacked currency. This practice proved to be successful in curbing inflation. The average inflation rate in the period from 1992 to 1995 was 1,125 percent; this rate was significantly reduced to 12.35 percent in 1996 and 1997. In addition, macroeconomic projections for Argentina suggest that inflation will continue to decline to 1.5 to 2.6 percent in the period from 1998 to 2002. Also, modest economic growth is expected in the next five years at 4.6 percent real GDP growth. A macroeconomic climate with low inflation, stable currency, and sustained growth augurs well for long-term investments that are

necessary in the cattle-beef sector.

An increasingly liberalized meat trade environment in Latin America, in particular, and in the rest of the world, in general, has also contributed to this recovery. The GATT opened markets for Argentine beef. In particular, significant access is given to Argentine beef in the EU, which gave Argentina a quota of 28,000 metric tons (mt) of high quality bone-in and boneless cuts out of its total tariff rate quota of 59,100 mt. Most of this imported beef goes to Germany. Also, in 1997 the United States allowed access of 20,000 mt Argentine fresh and frozen beef after Argentina met U.S. sanitary requirements for uncooked beef.

Finally, the proven resilience of the domestic cattle-beef sector is the most important driver in this recovery. This characteristic of the cattle-beef sector allowed Argentina to weather through the challenges it encountered in the 1990s. This resilience will allow the country to fully exploit the emerging opportunities today and in the near future. This resiliency is reflected in the way Argentina successfully shaped its export policy to work best for its industry during the

1990s. Its export product mix strategy acknowledges phytosanitary constraints while specializing toward products with higher unit value.

The major Argentine beef export product includes quarter, chilled cut, frozen cut, manufacturing grade, cooked and frozen, and corned beef. Of all product categories, the chilled beef export commands the highest unit value. The per unit value of processed beef exports is 71.54 percent of chilled exports, while per unit value of frozen beef export is only 47.03 percent of chilled exports.

In 1993, fresh meat (frozen and chilled) and processed meat exports accounted for almost an equal share at 50 percent, with chilled meat having a slightly higher share of 27.88 percent compared to 21.59 percent share of frozen meat. The high initial share of processed beef exports might be a deliberate product strategy of Argentina to overcome some sanitary concerns about uncooked beef meat. Under Office International des Epizooties (OIE) regulations, canning, cooking, and drying after salting are acceptable procedures to inactivate viruses present in meat,

and these processes would allow Argentine beef exports even in non-FMD endemic countries, which would have otherwise been legally banned.

The share of frozen beef export, on the other hand, expanded in 1995 at 46.84 largely driven by the ban of beef exports from the EU, the United Kingdom in particular, as a result of BSE. However, the share of frozen beef exports declined to 31.56 percent in 1998. High quality chilled beef meat export is the only product category that have shown a consistent expansion over the years. It gained some shares from processed beef exports in the early 1990s and from the frozen beef exports in the more recent period. This product is expected to gain more share in the mid to the long-run as there remains no more barrier for Argentina to penetrate the Pacific market with its FMD free status granted by the OIE in 1997.

With all these favorable factors converging at this time, it is no surprise that some outlooks project Argentina's beef exports to rise to 600 to 700 tmt in the next three to five years, a level that is well within Argentina's capability, as proven in its glory days. ●

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