

# Upward pressure on land prices come from several sources including some farm programs such as ARC

Agricultural policy makers are faced with two vexing challenges in responding to the long periods of low prices that farmers regularly face: designing programs that 1) do not result in the sale of agricultural products on the world market at prices that are below the cost of production (dumping) and 2) do not place upward pressure on the cost of fixed assets, particularly land, beyond the rate of inflation.

In this column we want to focus our attention to various causes of the increase in the price of land that exceeds the background rate of inflation for similar assets in the economy and secondarily identify policies that result in dumping.

Of course, much of the runup in land prices during the last decade was due to the sharp increases in agricultural prices as a result of the need for corn to make the ethanol required by the Renewable Fuels Standard. But other factors besides market prices and policy instruments put upward pressure on the price of land.

First, there is the demand for land for urban expansion. Agricultural land adjacent to urban areas is worth more to developers than can be supported by agricultural prices. The result is that most of this land is eventually sold and converted into housing developments, shopping areas, and industrial parks.

While some farmers take the money and either retire or go to work in town, some use that money to purchase similar farmland elsewhere. The availability of 1031 exchanges under Internal Revenue Service rules enables farmers near urban areas to sell their land at a significantly higher price than comparable land in more rural areas and defer capital gains taxes if they reinvest the money in a like asset. Because they have been able to sell their land for a higher price and defer taxes on the capital gains, they can pay more for land in more rural areas than the neighbors, leading to the increase in land prices in some areas.

Other pressures on land prices include people looking to buy 10-acre ranchettes as well as the demand for recreational land for hunting clubs. Individually, no one sale has a significant impact on land prices, but taken together they put an upward pressure on the price of agricultural land.

Turning to agricultural policies, the Price Loss Coverage program (PLC) only makes payments when the season average price paid to farmers is below the reference price which is below the full cost of production. In addition, payments are made on 85 percent of base acres times the program yield for that farm so in low-price times like the present they are inadequate. Even though PLC does not make US farmers whole it does contribute to the problem of dumping by partially compensating farmers when prices are below the reference price.

By way of contrast, the Agricultural Risk Coverage program (ARC) pays best in years when the county average revenue per acre (price times yield) is well above the county average cost of production per acre and the revenue per acre makes a significant decline from the previous year. With payments that can be made when revenue is above the full cost of production, the ARC program has the potential to drive up the cost of land. From our perspective, farmers should not expect taxpayers to provide them with profits above the full cost of production.

Sadly, when the revenue per acre is below the cost of production per acre, ARC makes diminishing payments to farmers and after four years of a price below the reference price, ARC will pay only when the county average yield drops below the previous year's yield. Again, these inadequate payments still contribute to the problem of dumping.

During years when prices were well above the full cost of production for most crops, the farm program that has had the greatest impact on land prices is crop revenue insurance. Crop revenue insurance makes payments to farmers when the revenue per acre is below the revenue per acre that the farmer expected at the time—before planting—the policy was taken out. The revenue decline could be the result of a decline in price or yield or both, even though the revenue per acre was above, and some years well above, the full cost of production. Again, farmers should not expect society, that is taxpayers, to provide them with profits above the full cost of production.

In talking about the full cost of production, we need to make it clear that this cost figure includes returns to land, labor, and management. It should not be the objective of farm policy to provide farmers with revenue above the full cost of production, because at that level farmers can pay all their production costs, including a return on land, and earn a payment for the time and skill they put into their farm operation.

If the return to land included in the full cost of production results in an increase in the price of land above the background rate of inflation for similar assets in the economy, then a portion of the return to land needs to be cut out of the calculation. Farmers should not expect taxpayers to provide them with money that drives up the price of land above the background rate of economy-wide price increases for that class of assets.

In contrast to other programs, supply management programs do not make payments to farmers unless they are for the environmental services that the farmer provides on land that is part of an acreage reduction program. If the marketing loan rate is set so there is no need for a counter-cyclical supplemental payment program, a supply management program will not result in the dumping of agricultural commodities on the market at a price below the cost of production.

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*Dr. Harwood D. Schaffer: Adjunct Research Assistant Professor, Sociology Department, University of Tennessee and Director, Agricultural Policy Analysis Center. Dr. Daryll E. Ray: Emeritus Professor, Institute of Agriculture, University of Tennessee and Retired Director, Agricultural Policy Analysis Center.*

*Email: [hdschaffer@utk.edu](mailto:hdschaffer@utk.edu) and [dray@utk.edu](mailto:dray@utk.edu); <http://www.agpolicy.org>.*

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