In the news: estate taxes, LDPs and growth in soybean and cotton exports

This week we want to discuss three issues that are in the news. It is true that we have covered them before, but sometimes it is worth reviewing the facts.

1) In an interview with DTN's Chris Clayton, "Charles Herbster, a Nebraska cattle producer and head of Trump's ag advisory committee," said "'We need to address the inheritance tax for those of us in the Midwest and the people who…have spent their lives building an agricultural business, building an animal business, a plant and crop business and they want to pass that on to their family. And today, in many cases, the next generation has to sell 25%, 30% or 50% of it, just to pay the taxes and that isn't fair because people have paid taxes all their lives. So we have got to get rid of the inheritance tax'" (http://tinyurl.com/jkmfnlj).

In another news report, Clayton was attending a meeting of Secretary of Agriculture Tom Vilsack with young farmers in Iowa. Vilsack went to Ames to announce the release of $17.8 million as a part of USDA's Beginning Farmer and Rancher Development Program. During that event, Vilsack had an open discussion of issues raised by the meeting attendees.

One of the concerns raised by the group was gaining access to land on which they could farm. Clayton then writes, "Keying in on tax policy and land transfer, the secretary criticized farm groups for focusing on repeal of the estate tax, or 'death tax' as it is often called by its opponents. The secretary noted the estate tax is paid by very few people and an even smaller number of farmers. 'Frankly, it is an incredible waste of time to talk about it because hardly anybody ever pays it,' Vilsack said.

"According to the IRS, there were 659 estates in 2014 that owned farm assets and paid the estate tax out of more than 11,900 estates that filed such returns" (http://tinyurl.com/hehmrmk).

From our perspective, these farm groups expend considerable political capital that could be used on issues that affect a larger number of farmers. In addition, if the inheritance tax is eliminated, it reduces the amount of money available in the federal budget for farm and other programs unless the cut is offset by a tax increase elsewhere.

When farmers sell their land it is already taxed at the long-term capital gains rate which is lower than the rate for earned income. In addition, when land is inherited, the heirs receive it at the stepped-up basis (its value at time of inheritance). That means that the heirs can sell it with minimal tax consequences, a not insignificant tax benefit.

2) As the 2014 Farm Bill was being debated, many people paid little attention to the idea of ensuring that we had a program that was truly counter-cyclical—that is, the lower the prices, the higher the counter-cyclical payments, and above a certain level no payments would be made. Looking at high prices for corn and most other agricultural commodities, the argument was made that we were on a new plateau and prices would not drop below that level for any substantial period of time.

When we argued that without a price floor, we could see prices drop into LDP (Loan Deficiency Payment) territory, these same people looked at us like we were deluded children and confidently said, "It will never happen." They had lots of reasons: the cost of production would set a lower limit; with an expanding world population, food demand would keep prices at the then current levels; and on and on the reasons went.

We came to our conclusion by looking at the history of crop prices. Prices were sustained at high levels during three periods in the 20th century, WWI, WWII, and the mid-1970s. During the rest of the time, prices remained low for long periods of time interrupted by an occasional price spike resulting from a crop failure somewhere in the US. We saw no reason why the ethanol boom would end differently than the three previous price booms.

While Harwood was at the annual meeting of the Indiana Farmers Organization, the talk turned to prices, particularly low corn prices and he ventured that corn was nearing LDP levels in some places. One of the farmers in attendance said, “They’re already there for wheat.”

As this column is being written, we took the time to look and see for ourselves. Across wide swaths of Kansas, Oklahoma, Colorado, and Nebraska the effective LDP rate is between 2 and 6 cents. That is not a lot of protection at current prices, but it is an indication of the problems all farmers face in the coming year unless the corn and soybean harvests come in well below expectations or demand surges.

3) The current debate over the TPP, which both presidential candidates oppose, often focuses on the number of acres of oilseeds, grain, and fiber that is exported. And it is true that exports are an important part of the US crop market. The question is to what extent are the levels of exports influenced by US trade agreements or are there other factors at work.

Over the last decade-and-a-half, the huge run up in soybean and cotton exports has not been driven by any of the trade agreement that US signed with other nations. The huge run-up in soybean exports was driven by an internal political decision in China to focus on growing food grains and importing soybeans to meet the needs of Chinese meat producers.

Likewise the growth of cotton exports is directly related to the loss of cotton mills and clothing manufacturing in the US. As the production of blue jeans, tee shirts, sweatshirts, and various apparel items was outsourced to other countries, the sale of cotton followed. But for cotton producers this was not a “new” market, it was the same old “domestic” market moved to another country. We exported cotton to produce clothing that we formerly produced in the US with domestic cotton.

For the other crops, the US is the residual supplier for the remainder of the world. Sure, there are markets that prefer to buy from the US, but that demand is steady. What provides a one-year growth in exports is the need by another country for imports resulting a crop shortfall, either in that country or one of our export competitor countries.

Next week we will review the fundamental behavior of agricultural markets.

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