



KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

Vol. 5, No. 2
July 18, 2001

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UNCLE SAM HAS BEEN VERY GOOD TO ME

by Russ Morgan

Most Americans delight in complaining about our Federal Government - the bureaucratic inefficiencies, burdensome regulations, and onerous tax structure. However, those of us associated with production agriculture may wish to hold our tongues before we complain too loudly. Government monies, in the form of Production Flex Payments, Loan Deficiency Payments, Marketing Loss Assistance, Market Gains, Crop Disaster Program and the ever present Conservation Reserve Program have often been the difference between positive and negative Net Farm Income for Kentucky farmers. Based upon analysis of preliminary data that will be presented in the 2000 Annual Financial Summary of the Kentucky Farm Business Management Program, the average commercial Kentucky farm would have incurred a Net Farm Income of \$ 35,225 instead of the \$ 127,357 profit actually reaped had “mailbox farming” not been an available enterprise.

For the average Kentucky farm, government payments represented 17.83% of Gross Farm Returns in 2000 and 72.34% of Net Farm Income. As one would expect, profits for grain farms were much more reliant on government payments than beef, dairy or hog farms.

The following tables present government payments and relationship to Gross Farm Returns (GFR) and Net Farm Income (NFI) for the average Kentucky farm in 2000, 1999 and 1998 by farm type. It should be noted that the relationship between government payments and GFR / NFI is not perfectly 1:1. A reduction in certain government payments (e.g. LDP's) may be partially offset by increases in other revenue or decreases in expenses. However, the relationship is expected to be quite close to 1:1.

Farm Type	Govt Pmts \$	% of GFR	% of NFI
KY	92,132	17.83%	72.34%
Grain	124,074	20.70%	85.84%
Beef	7,938	7.60%	49.22%
Dairy	14,322	4.26%	23.15%
Hog	40,637	9.27%	25.39%



Table Two: Govt Payments - 1999			
Farm Type	Govt Pmts \$	% of GFR	% of NFI
KY	80,660	18.35%	131.33%
Grain	124,651	22.46%	193.96%
Beef	9,991	7.72%	80.00%
Dairy	20,606	5.95%	28.25%
Hog	26,566	8.72%	39.06%

Table Three: Govt Payments - 1998			
Farm Type	Govt Pmts \$	% of GFR	% of NFI
KY	52,077	13.66%	488.34%
Grain	55,826	13.31%	422.06%
Beef	8,774	6.24%	N/A ¹
Dairy	18,587	5.02%	35.96%
Hog	23,020	10.10%	N/A ¹

¹ NFI was negative.

On average, government payments increased almost 77% from 1998 to 2000. The largest raw and relative increase was incurred by grain farms (\$ 68,248 or 122.25%). Interestingly, government payments DECREASED, both in raw dollars and relative importance, for dairy and beef farms in 2000.

Upon cursory review, one may be tempted to argue that government payments were relatively more important to the farm business “bottom line” in 1998 than 2000. However, keep in mind the direct relationship between gross revenues and NFI. Perhaps a better analysis is comparing NFI for 1998 and 2000 had 2000-level government payments been available in 1998. The table below presents this comparison for all Kentucky farms and by farm type.

Table Four: Govt Payments - 2000 level available in 1998			
Farm Type	1998 NFI	1998 NFI with 2000 level govt payments	2000 NFI
KY	10,664	50,719	60,674
Grain	13,227	81,475	144,537
Beef	(4,578)	(5,414)	16,128
Dairy	51,687	53,706	71,660
Hog	(62,041)	(44,424)	160,035

Obviously, from Table Four, it is evident that factors other than the level of government payments significantly impacted the change in NFI from 1998 to 2000 on Kentucky farms. As

one would expect these non-government payment factors were greatest on livestock farms (e.g. hog prices and beef prices rebounded from previous years).

It seems to be debatable whether government payments were more “important” in 1998 or 2000. However, the fact remains that if the role of government income in production agriculture is diminished and farm product prices do not increase proportionately, many commercial farms will be operating in the red - some by a large margin.

The policy question for politicians soon to be elected is whether continued direct payments to farm producers (seemingly violating the concept of “Freedom to Farm”) is the short-term and/or long-term answer or is a return to the supply-control methods of old preferable. Perhaps another, more comprehensive policy addressing domestic and international markets and marketing can be developed by the incoming congress. Obviously, the strategy adopted will be critical to the financial health of farm businesses.

NEW MARKETING OPPORTUNITY FOR PROGRESSIVE BEEF PRODUCERS

by Kenny Burdine

The beef cattle industry is in the midst of major structural change to provide a more consistent and palatable beef product for the consumer. Toward this end, the industry in the eastern corn-belt must become part of this responsive production and marketing system. The Five-State Beef Initiative (FSBI) is a cooperative effort between the states of Illinois, Indiana, Kentucky, Michigan, and Ohio. The FSBI is a coordinated production system made up of producers, processors, and vendors working together to develop a system that responds to the concerns of the consumer and captures the true value of our beef products.

In Kentucky, the initiative is a coordinated effort among the Kentucky Department of Agriculture, Kentucky Cattlemen’s Association, Kentucky Farm Bureau, and the University of Kentucky. The participating states have received a USDA grant to assist them in implementation over the next three years. The system is designed to provide feedback to the producer from the time the animal leaves the farm until it is slaughtered, through the use of electronic identification tags and a comprehensive data management system. This information will provide producers with the tools needed to make management and marketing decisions.

We are looking for producers interested in targeting their cattle towards premium markets and who are willing to make necessary management changes. These producers will have the opportunity to become partners in the project. Partnering producers must provide basic production information, participate in a uniform health program, and market calves in a

way that allows data to be obtained. In the first year, the Kentucky contingent tagged 2300 cattle and is currently in the process of retrieving feedlot and carcass data.

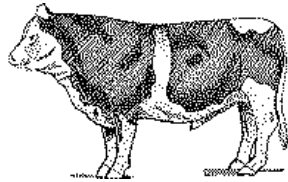
Creating a true, value based marketing system that rewards cow-calf producers, backgrounders, feedlots, and packers is the goal of the FSBI.

Interested producers should contact their county agriculture agent, Dr. John Johns at (859) 257-2853, or Tim Dietrich at (502) 564-5665 ext. 273.

WHY AREN'T YOU DOING ENTERPRISE ANALYSIS?

by Colby Blair

As we reflect on our records from year to year I hope we are trying to digest more than an IRS Schedule F. By being a member of the Kentucky Farm Business Management program we are privy to many financial statements including the income statement, balance sheet, statement of cash flows and a summary of various financial ratios. These reports contain a wealth of information from which we can make informed decisions regarding our farm business. Sitting down with your Farm Business Analysis Specialist should be at the top of your list of priorities for each year. While these financial statements can provide us with a general overview of our farm business, I feel that if we attempt to dig further into these statements we can begin to see the internal makeup of these financial reports. One way to do this would be to perform enterprise analysis.



A wide range of businesses use what is termed as "Job-Order Costing" to determine the viability of certain activities or jobs within the particular trade or business. Enterprise analysis can be seen as an extension of "Job-Order Costing". Enterprise analysis will allow one to allocate all returns and all costs for the given year to various enterprises within the total farm. Then one can determine which enterprise is pulling the farm wagon and which enterprise is stuck in the mud.

Many non-participants of enterprise analysis will say, "Well, I have only two enterprises on my farm - cattle and tobacco." I beg to differ. In most cases that particular farm has a hay and/or alfalfa as well as a corn and/or corn silage enterprise. Why would one do a hay or alfalfa enterprise analysis when all of the crops that are grown on the farm are fed to the livestock? Even if the raised crop is not sold to another party, it still holds a value and needs to be viewed as being "sold" to the consuming enterprise. By doing this, we can put a fair market value on the raised crop, allocate the expenses incurred while raising it and determine if we are making the right decision by raising that crop for our livestock to

consume. We may come to find that it costs us more to put up that hay, grain or silage than it can be bought for on the open market. From there we may be able to concur that it is not really necessary to have all of that machinery in the shed.

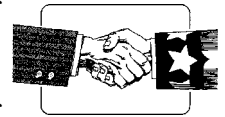
We may find that one particular enterprise created an astounding net income in relation to the other enterprises. Now, I am not advocating that after performing enterprise analysis in our farming business we should be able to pick one enterprise, delete all others and get rich immediately. Realize that livestock enterprises may require other enterprises to support the viability of the livestock aspect of the farm business. We also need to consider cash flow requirements. Sometimes we may need a certain enterprise, not because it makes a lot of money, it may in fact be a money loser, but the timing of the cash inflows as a result of that enterprise may provide enough reason to continue it. Other businesses, like Wal-Mart and Kroger, have "loss leaders". They are seen as necessary components of the total operation.

As always, KFBM prides itself in providing its clients with accurate and useful information concerning their farm business. If you are not presently using enterprise analysis on your farm ask your Farm Business Analysis Specialist to assist you. You will find it useful, and yet another piece of information that can be used in making informed decisions.

THE 2001 TAX ACT

by Darwin Foley

President George W. Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 on June 7, 2001. The bill sets in motion a ten year plan of tax relief that begins in July of this year with the mailing of over 90 million rebate checks. Many of the tax cuts are pushed far into the future, and what the government giveth, the government may take away. Hidden in all the hoopla are two threats that may chill the tax relief. First, this bill allows prior law to be reinstated in 2010 unless congress acts to extend the law. Second, the law did not deal with the alternative minimum tax, a parallel tax calculation.



Alternative minimum tax is the more immediate concern. According to a June 8, Courier Journal article: "A growing number of middle-class Americans will be hit with the alternative minimum tax, which was originally aimed at making sure the very rich don't avoid tax through tax shelters or other means. While the bill cuts the top tax rates, it doesn't reduce the tax rates for the minimum tax. So under the legislation one of every three taxpayers could end up paying the minimum tax by 2011, essentially wiping out much of the savings from the tax cut."

Rebate checks are scheduled to begin going out the week of July 23. The order will be based on the last two digits of your Social Security number. Generally, the maximum is \$300 for single filers with taxable income of \$6,000 or more, and \$600

**Table One: Brief Summary of Some of the Provisions
of the Economic Growth and Tax Relief Act of 2001**

Item:	New Law:
Individual income tax rates	A new 10 percent tax rate, effective January 1, 2001 applies to the first \$6,000 of taxable income for single people, and the first \$12,000 for married couples filing jointly.
2001 Tax brackets	Prior tax brackets were 15%, 28%, 31%, 36% and 39.6%. For 2001 the brackets will be 10%, 15%, 27.5%, 30.5%, 35.5%, and 38.6%. The rate reduction is actually 1% for the higher brackets, but because the reduction begins July 1, the effective reduction for the higher brackets will be 1/2% in 2001.
Future brackets	For 2002 and 2003 the rates of 28%, 31%, 36% and 39.6% will be reduced to 27%, 30%, 35%, and 38.6% respectively. The rates will decrease one percentage point each even numbered year until the final rates of 25%, 28%, 33%, and 35% respectively are reached in 2006.
Withholding tables	Withholding tables are changed effective January 1 st of each year. National Association of Tax Professionals advises: "Change withholding as soon as possible for 2001, to take into account the rate changes for 2001."
Child tax credit	The prior \$500 credit for each child under age 17 is increased as follows: 2001 - 2004 - \$600, 2005 - 2008 - \$700, 2009 - \$800, 2010 - \$1,000.
Marriage penalty	The "marriage penalty" will gradually disappear beginning in 2005. The standard deduction for married couples will gradually rise, and the 15% bracket ceiling for Married Filing Jointly will be phased in over four years (beginning in 2005) to twice the Single bracket.
Retirement plans	Individual Retirement Account contribution limits will gradually rise from \$2,000 to \$5,000 by 2008 with no change in the income limits. Contribution limits for tax-deferred 401(k) type plans will gradually increase from \$10,500 to \$15,000 in 2006.
Education	The contribution limit on Educational IRAs is increased from \$500 to \$2,000, effective in 2002. A maximum \$3,000 deduction for higher education tuition for 2002-2003, rising to \$4,000 for 2004-2005 with income limitations (the deduction is not permitted for a student who takes the Hope or Lifetime Learning Credit). The income limitation for deduction of student loan interest is increased. Interest earned on educational savings accounts (529 plans) are exempt from federal income tax. Educational savings accounts now look like the best way to save for education.
Estate tax	The current \$675,000 individual exemption will rise to \$1 million in 2002, \$1.5 million in 2004, \$2 million in 2006 and \$3.5 million in 2009. The estate tax is repealed for deaths after December 31, 2009, but just for one year. The top 55% rate will drop immediately to 50%, and eventually to 45%.

for married couples filing jointly with taxable income of more than \$12,000.

For an easy online way to calculate your rebate, check out **Kiplinger's Rebate-O-Meter** at <http://www.kiplinger.com/php/taxrebate/>. For a brief summary of some of the provisions check Table One below.

KFBM WEBSITE UPDATE

by Daniel Green

The KFBM website (<http://www.uky.edu/Ag/KFBM/>) is undergoing some changes that will be posted to the site soon. These changes will include an updated appearance as well as additional content including several links to sources of useful farm management information.

REMINDER

The Summer Board Meeting will be in Lexington July 24. Tours start at 11:00 AM and the dinner and business meeting will follow. If you need information call your specialist.

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