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# KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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## **Grain Markets Craig Gibson**

As this is written, the grain markets have again demonstrated another day of extreme emotions. Corn and soybeans opened higher as a result of further deterioration in weekly crop conditions. However, forecasts for cooler weather and some rain caused corn to close nearly unchanged and soybeans about 10 cents lower. Weather markets, such as what we are currently experiencing, are not worth explaining. Prices are pushed too far and too fast for any rational discussion.

On August 12 the USDA provided estimates of the U.S. crop. Surprising many, U.S. corn production was lowered from the July report estimate to 10.064 billion bushels. The average U.S. yield was lowered from 142.7 to 139.9 bushels per acre, based on August 1 conditions. U.S. soybean production was also lowered from 2.885 billion bushels (39.7 bushels per acre) to 2.862 billion bushels (39.4 bushels per acre). These compare to production level estimates for 2002 of 9.008 and 2.73 billion bushels for corn and soybeans, respectively. In combination with hot and dry weather worries, corn and soybean prices have continued to rally since the report.

Monday's weekly crop condition report showed a change in the good to excellent categories for corn from 60% to 50%. One year ago, these categories totaled 42%. Soybeans were rated 48% in the good to excellent categories. They were rated 56% on August 18, 2003 and rated 46% on August 26, 2002. These changes were deemed significant. Will moderating temperatures and scattered rainfall improve the crop conditions in September? Regardless, more than likely we will find lower production estimates in the September USDA production estimates than shown in the August report. For producers making pricing decisions, the major question is whether current price levels are in line with USDA's September estimates when released.

Based on today's price action, some market analysts feel that we may have seen an interim market top. This is based on the fact that markets often "top" when "bullish" news fails to cause the market to close higher. Corn was 7 cents higher during the day and closed nearly unchanged. Soybeans were 10 cents higher during the day and closed 10 cents lower. These same analysts are recommending sales of expected production up to the 50% level. I

believe that the percentage of crop sold will depend upon whether or not storage is available. Producers with limited on-farm facilities should consider a more aggressive marketing stance.

As in the 2002-03 marketing year, current market price spreads demonstrate that returns to storage favors corn. Soybean futures show about a 2-cent spread between November and January. Corn futures show nearly a 7-cent spread between December and March. Consideration of local basis increases the spreads between harvest and January deliveries to roughly 12 cents and 22 cents for soybeans and corn, respectively. Natural shrinkage and/or additional trucking for soybeans will remove nearly all, if not all, benefit of storing soybeans on-farm. Placement of soybeans in on-farm storage appears beneficial **only** if prices move higher after harvest. As someone recently mentioned in a presentation, “risk-loving gamblers” use this approach to marketing. Another descriptive phrase is “hold and hope.”

Everyone is complaining about energy costs. Just as gas prices have moved higher at the pump, so have propane and natural gas prices. Returns to drying are obviously jeopardized this year. Balancing harvest loss against drying costs is always difficult. It is no different this year. Subject to commercial elevator moisture discounting methods, producers with drying facilities have a choice whether harvest deliveries should be dried on-farm or delivered directly from the field. When producers confront this decision, they must understand the moisture discounting method used by their local elevator to make the best decision. Just as cash prices vary by elevator, moisture-discounting methods used by western Kentucky elevators vary.

Generally, western Kentucky elevators use three different moisture-discounting methods. Without going into specific detail, it appears that returns to drying for corn are generally positive at moisture levels above 22 percent, even with the higher energy costs. In other words, when moisture levels are below 22 percent, it costs more to dry the corn on-farm than to assume the moisture discount at the elevator. This is one reason producers should consider moving corn harvested first to the on-farm storage.

Another reason producers should consider moving the corn harvested first to the on-farm storage is the possibility of loan deficiency payments (LDPs). LDPs are only available for harvested grain.

Currently, there are no LDPs available for corn, soybeans, or grain sorghum. There may be later! Do not underestimate the markets!

From a historical view, the maximum LDP for corn has occurred on a date between September 22 and October 4. The maximum LDP for soybeans has occurred between October 10 and October 27. No LDPs were available for corn during the 2002 harvest. There were four days during 2002 that there was an LDP available for soybeans. The dates were October 10 – 14, 2002. Producers should realize that even though LDPs are closely related to local cash prices, **it is possible that an LDP can be available even though local cash prices are above the respective county loan rate.** This is because of the “terminal market differential” used when calculating the daily posted county price (PCP). Often, LDPs dramatically change when the terminal market differential changes. It remains to be seen what happens this year. During harvest, prudent producers will be monitoring LDPs daily.

The grain market will be driven by weather events. Weekly crop conditions reports will also contribute to price direction. There will be another USDA production estimate report on September 11. This will be an important report. Although the market does not have a history of moving higher into September, it did last year. However, the pre-harvest highs occurred at about the same time as when the September report was released. Please realize that this is no guarantee that it will be the same in 2003.

Given the level of uncertainty, it appears that producers with unsold grain should be setting realistic price targets. Historically, targets of \$2.60 for corn and \$6.00 for soybeans appear realistic. At this time, I see no reason for 2003 targets to be different. Of course these levels are more realistic for crops stored on-farm than those delivered during harvest. Therefore, fall delivery price targets will be lower. The important point is that producers implement a marketing plan immediately!

## **Review of “Jobs and Growth Tax Relief Reconciliation Act of 2003”**

**Suzy Martin and Rush Midkiff**

The “Jobs and Growth Tax Relief Reconciliation Act of 2003” was signed by President Bush on May 28 of this year. This created many changes taxpayers and

business owners should be aware of for this tax year. They include potentially receiving money based on the child tax credit information from 2002 returns, changes in the tax brackets, standard deductions, capital gains rates, and depreciation/write-off amounts.

The maximum child tax credit has increased from \$600 to \$1,000 per child. Qualifying taxpayers could possibly receive a check for up to \$400 per dependent child born after 1986 based on information in their 2002 tax return. The checks are actually an advance payment of the increased portion of the child tax credit for 2003. No action is needed by the taxpayer to receive an advance payment check, similar to the checks taxpayers received in 2001.

The income tax brackets and standard deductions have also changed under the new tax act, partially in an effort to help eliminate the so called "marriage penalty". The rates will drop from 27%, 30%, 35% and 38.6% to 25%, 28%, 33% and 35%. The 15% rate bracket for married taxpayers filing jointly and qualifying widow(er)s has expanded to twice that of single filers. The maximum taxable income subject to the 10% tax rate has increased to \$7,000 for single taxpayers and married taxpayers filing separately (\$14,000 for married filing jointly and qualifying widow(er)s). The basic standard deduction for married filing jointly has increased to \$9,500 (twice that of single filers). The standard deduction for married filing separately has increased to \$4,750 (the same as that of single taxpayers).

Effective for capital gains on or after May 6, 2003: A 5% rate applies to any portion of a capital gain that would otherwise fall into the lower 10% or 15% ordinary income brackets. A 15% rate applies to any net long-term capital gain that would be taxable in the upper ordinary income tax brackets.

A few notes for producers for future reference: In 2008, the effective rate for the lower tier (5% capital gain rate) drops to 0%. Effective for 2009 and after, old law rates are restored so we go back to 10% for income in the 15% income tax brackets and 20% for the upper tier. Gains reported from installment sale collections qualify for the new 5% and 15% rates for payments if collected after May 5, 2003.

Taxpayers might want to consider taking advantage of the reduced rates if they have some non-income producing assets or are sitting on timber because

capital gains tax rates were too high. However, the tax laws (like the grain market) seem to change daily.

To potentially stimulate business spending, the Section 179 (immediate write-off of equipment) and the special 30% depreciation laws have changed. In tax year 2002, the Section 179 limit was \$24,000 and was phased out when equipment purchases exceeded \$200,000. For qualified property placed in service in tax years 2003, 2004, and 2005 the Section 179 limit is increased to \$100,000 and does not phase out until total equipment purchases exceed \$400,000. If the depreciation/write-off laws weren't confusing enough, the new tax act also changes the rules on the "special 30% depreciation" which was enacted in 2002. Last year, businesses were able to expense 30% of brand new equipment. The new law allows for a 50% write-off on new equipment purchased after May 5, 2003, and before January 1, 2005. To sum up the new depreciation laws; businesses can potentially write off \$100,000 of eligible Section 179 equipment, and/or (on brand new equipment) they can write off 50%, 30% or opt to write-off none at all. Simple?

## **Farm Income Declines in 2002**

### **Terry W. Moss**

Results from soon to be published data generated through the KFBM program indicate that farm earnings declined significantly in 2002. Net farm income for all farms included in the 2002 averages was \$48,653 compared to \$112,832 in 2001. The reduced earnings were exhibited by all of the associations across the state of Kentucky with the exception of the Purchase Association.

Income levels for farmers in Central Kentucky (Lincoln Trail, Louisville & Bluegrass Association) have dropped two years in a row, from record levels achieved in the year 2000. Earnings for farmers in the Ohio Valley area have exhibited similar trends, peaking at \$144,804 in 2000, declining to \$90,393 in 2001 and dropping further to \$8,034 in 2002. Income for farmers in the Pennyroyal and Purchase Associations have dropped significantly since the mid 1990's a time period which would be considered one of the most successful in the history of these groups.

There were several reasons why farm earnings dropped in 2002. Many observers will cite the drop in government payments as the major factor. Indeed,

**Table 1. Net Farm Income by Area<sup>1</sup>**

	Purchase	Pennyroyal	Ohio Valley	Lincoln Trail	Louisville <sup>2</sup>	Blue Grass
1989	70507	61785	81857	68171	47679	31462
1990	69560	39506	56040	45326	62856	41414
1991	33741	41083	30233	42045	29098	9216
1992	124200	107823	113440	72416	57021	44738
1993	89019	68956	88646	87214	66439	36024
1994	102586	97986	71877	31140	23685	16691
1995	175257	119564	75938	69696	50990	6037
1996	163808	190374	94838	75439	49461	27377
1997	104994	99765	53151	30991	21189	34505
1998	30312	13862	-6378	-4389	37106	10107
1999	69502	73046	51715	58896	46415	29779
2000	170678	117582	144804	128724	135069	66056
2001	88324	147171	90393	65451	72842	48131
2002	89201	75547	8034	26149	NA	-1319
10 Yr Ave	108368	100385	67302	556931		27339
5 Yr Ave	89603	85442	57714	54966		30551

<sup>1</sup>Data summarized by David L. Heisterberg and Gregory A. Ibendahl, Dept. of Ag Economics, Univ. of Kentucky

<sup>2</sup>Louisville Area was divided between the Lincoln Trail & Bluegrass Areas in 2002

the average FSA/Set Aside payments (cash and accrual) per farm operation did drop for all associations and by more than \$75,000 for the Ohio Valley and Pennyroyal groups. However, an understanding of the Farm Security and Rural Investment Act of 2002 should lead to the recognition that lower payments were due to an increase in grain prices, which should have, theoretically, enhanced farm earnings.

An equally significant reason for the decline in earnings in 2002 was the drop in crop yields, particularly corn and wheat. Corn yields were down for all associations, with farmers in the Ohio Valley and Purchase areas experiencing a 40 bushel yield reduction. The corn yield reduction in the Bluegrass Association was over 60 bushels per acre. Wheat yields were down by over 20 bushels per acre for some groups.

The trend in soybean yields varied across the state. Double crop soybean yields actually increased in the

Pennyroyal Area, a reflection of a somewhat atypical weather pattern, which brought more summer rainfall later rather than early in the season.

On top of lower yields, livestock farmers across the state had to contend with lower prices for hogs, beef and milk. Prices received for market hogs for producers in the KFBM program averaged \$35.31 per 100 LBS compared to \$44.11 in 2001. Beef calf prices for calves sold at weaning were \$77.30 per 100 LBS, almost \$10 below the 2001 earnings of \$87.07. Milk prices dropped from \$16.20 per 100 LBS in 2001 to \$13.29 last year. Returns per \$100 feed fed were lower in 2002 for all major livestock enterprises.

Adverse weather, lower crop yields, lower returns from livestock enterprises as well as less government payments were all detrimental to profitability in 2002. Yet, taken as a whole, earnings for many should have been sufficient enough to provide some measure of financial stability, if not the growth

afforded by earnings in former years. Observations of the 2002 results do point out that average income levels varied from area to area and also serve to illustrate the point that these averages are comprised of individual operations with a wide range of results. Hopefully, by this time, all KFBM members will have had the opportunity to review their own 2002 results with their specialists, discuss reasons why results were what they were, gauge the impact of their results on their operation and look for ways to make needed improvements for the future.

## **Tobacco Quota Buyout Update**

### **Will Snell**

The discussion surrounding tobacco quota buyout legislation has been elevated in recent weeks in Washington DC. But of primary concern is the time left within this session to successfully complete a buyout in 2003 – the year most believe it must happen if it is ever going to occur. The House Ag Committee heard from tobacco farmers, health groups, and tobacco companies about their viewpoints on a quota buyout in a hearing held in late July. Most of the attention in the hearing focused on Congressman Fletcher's and Congressman McIntyre's buyout bills that were reintroduced in January 2003. In addition, Senators McConnell and Bunning, along with other tobacco-state senators introduced the Tobacco Market Transition Act of 2003 in late July. (For a review of all the House and Senate bills see

[http://www.uky.edu/Ag/TobaccoEcon/publications/womach\\_rl31790.pdf](http://www.uky.edu/Ag/TobaccoEcon/publications/womach_rl31790.pdf))

Congress was in recess during the month of August and will return following the Labor Day holiday. Thus, in reality, upon their return there may only be around 6 to 8 legislative weeks (or even less) to get buyout legislation passed this year. Obviously, a lot has to occur in a short-time frame. First, it was clear following the House Ag Committee hearing that many members were concerned over the cost of buyout legislation, the financial implications of a buyout on tobacco manufacturers, and the post-buyout program components of a buyout bill. Thus, efforts have been made in August by farm group leaders and tobacco state lawmakers to address these concerns. Consequently, a modified Fletcher bill is expected to evolve in early September. Ideally, KY farm group leaders are hopeful that Congressmen Fletcher and McIntyre can come together, along with the other tobacco-state representatives with a single House buyout bill. This modified bill will likely be

less than the original \$19-20 billion Fletcher bill, but still retain 1998 as the base year (with some potential adjustments) and perhaps a revised version of a production management/safety net program that is somewhat stronger than the language offered in the \$13 billion Senate bill, yet much different from our current tobacco program.

Efforts to get a consensus bill moving in the House appear critical by at least mid to late September. As for the Senate, attention will be focused on the markup of a FDA bill in early September, with the possibility of it moving parallel with the Senate buyout bill. In addition to gaining united support among the tobacco states for the buyout bills in both chambers, efforts must continue at an even greater level to seek support from non-tobacco states. Tobacco-state policymakers must convince their non-tobacco state colleagues that the buyout provides them with an opportunity to eliminate the current controversial federal tobacco program, provide their constituents with public health benefits, and perhaps reduce anticipated losses of their state's MSA payments due to the escalating volume of cigarettes being sold outside of the MSA. In addition, this policy vehicle may be able to continue to provide some degree of support to existing tobacco farmers, just like the farm bill did for other commodities, but likely without the use of any taxpayer funds. This remains a tough sale outside of tobacco states. In addition, many of the major tobacco companies continue to feel threatened by FDA regulation and argue that buyout payments will result in a tremendous financial burden on their companies. Consequently, the buyout remains a possibility for 2003, but will have to overcome a tremendous amount of political challenges for it to occur. If it does occur, Kentucky agriculture can expect some major structural changes in terms of the number of tobacco farms, the size of tobacco farm operations, their location, and possibly how the crop is produced. If it does not occur, quotas will likely continue to fall, lease prices will remain at or near record levels and the overall outlook will remain very depressed. As a result, farm group leaders will be forced to take a step back and review the structure of the existing tobacco program in order to make some policy adjustments (likely outside of a buyout) to improve the deteriorating competitive position of U.S. tobacco in the world marketplace. Obviously, the latter option is one that is not very well spelled out at the present time and one that will likely be very unpopular. Thus, all efforts will continue to be directed toward

successful completion of a buyout in the U.S. Congress in 2003

## **Tobacco Lawsuit Colby Blair & Will Snell**



### *DeLoach v. Philip Morris Companies, Inc., et al.*

The lawsuit alleges that the major tobacco companies “unlawfully agreed and conspired to restrain competition and fix prices for and allocate domestic flue-cured and burley tobacco sold at tobacco auctions in the United States, and engaged in other unlawful conduct to stabilize prices of tobacco at levels below those that would have existed in a competitive market”. By doing such, the companies caused the quota under the federal tobacco program to be depressed.

The class was defined to include all domestic producers and quota owners of flue-cured or burley tobacco who sold at auction or were authorized to grow flue-cured or burley tobacco in the United States any time from March 1, 1996 to February 28, 2001.

A proposed settlement has been reached with all major tobacco companies except R.J. Reynolds Tobacco Co. All claims remain in effect towards R.J. Reynolds Tobacco Co. The proposed settlement contains four parts.

1. Philip Morris USA, Brown & Williamson and Lorillard will commit to purchase a total of at least 405 million pounds of domestic flue-cured and burley tobacco annually. Within the agreement, Philip Morris, Brown & Williamson, and Lorillard agreed to a minimal purchase agreement of 405 million pounds annually for the next 10 years (or 12 years if a buyout occurs), subject to changes in overall cigarette production. Philip Morris’ annual minimum commitment is 330 million pounds, with Brown & Williamson minimum level at 55 million pounds and Lorillard at 20 million pounds. Total U.S. burley and flue-cured purchases by the domestic manufacturers, including RJR have generally been in the 500 million to 1 billion pound range over the past decade. But actual purchases and intention levels have certainly exhibited a significant downward trend during the post Master Settlement Agreement (MSA) era. For 2003, burley and flue intentions totaled 468 million pounds, of which the manufacturers are required to buy 90% (assuming 100% of the quota is produced).

Keep in mind a couple of items in reviewing these data. First, this is a minimum purchase level for the major U.S. cigarette manufacturers, excluding RJR (which based on recent purchase behavior would not significantly change the total volume). Second, this minimum purchase level will likely be adjusted downward as imported and deep discount cigarettes continue to erode the settling manufacturer’s market share, along with expected further reductions in U.S. cigarette consumption and exports. In addition to the volume commitment, there is also a percentage domestic content commitment. Philip Morris agreed to a minimum domestic content level of 70% for flue-cured and 65% for burley, while Brown & Williamson and Lorillard agreed to a 35% level for U.S. tobacco. This domestic content level is applicable only to cigarettes produced and consumed in the U.S. The anti-trust case against RJR continues with an April 2004 court date.

2. Philip Morris USA will pay \$8 million into a fund to be used for leaf tobacco research and extension programs. Up to \$5 million of this can be used for lobbying Congress for a buyout.
3. Settling defendants will pay \$200 million in cash to be distributed equally (\$100 million to growers and \$100 million to quota owners) to eligible class members based upon the number of pounds of tobacco they sold and/or the number of pounds of quota they owned that authorized them to grow flue-cured or burley tobacco in the United States during the period March 1, 1996 through February 28, 2001. It is important to note that only auction, not contract; pounds are eligible for grower compensation. Quota owners will be paid regardless where the tobacco was sold.
4. Philip Morris USA, Brown & Williamson and Lorillard will pay the reasonable fees and costs of the plaintiff’s attorneys, in an amount to be determined by the court. Those fees and costs will be in addition to the sums listed above and will not reduce any payments to the Class.

Class members can choose to remain in the class by doing nothing. However, in order to be eligible for payment from the cash portion of the payment, a Claim Form must be submitted and postmarked by October 14, 2003. Persons wishing to be excluded from the class must have done so in writing. These requests must have contained the same information that the Claim Form requires in addition to a signed statement requesting exclusion. These exclusion

requests must have been postmarked no later than August 13, 2003.

Further information can be obtained on the internet at [www.deloachclassaction.org](http://www.deloachclassaction.org), via phone at 1-800-371-9820 or by mail at DeLoach v. Philip Morris Litigation, P.O. Box 9000 #6072, Merrick, NY11566-9000.

Farm Services Agency is now ready to provide quota owners and growers with the data they need for the application. Your local Cooperative Extension Service Agents are also willing to answer questions regarding the lawsuit application. However, neither the FSA nor the CES agents will be in a position to help the farmer fill in the application. The October 14<sup>th</sup>, 2003 deadline is a court ordered deadline and one that will not be extended, unless the judge grants an extension, which does not appear likely.

### **Notes from the Department Lynn Robbins, Chair**

This is the first of a regular feature for our state newsletter. I want to improve communication, so someone from the department will write for every newsletter.

In June, Associate Dean of Extension, Larry Turner appointed a committee to take a close look at the general effectiveness of KFBM. An eight person Committee consisting of two cooperators, two specialists, two Ag Economics Faculty members, and two College administration representatives were charged to get a full view of all partners' perspectives.

The results of the review were presented to Dean Smith and Dr. Turner on July 9<sup>th</sup> and were shared with the State Board July 24<sup>th</sup>. The committee's main recommendation was that, "The College of Agriculture should continue to operate KFBM in cooperation with the regional associations but the long-standing issues and concerns must be addressed immediately." The report supplied eighteen other specific and helpful recommendations

After hearing the report Dean Smith and Dr. Turner lauded the committee for their excellent work and noted that five of the recommendations carried especially high administrative priority. (You can get the full report from your association's specialist(s) or look at it on line at

<http://www.uky.edu/Ag/AgEcon/fbapubs.html>). The five priority recommendations follow:

1. Immediately move to hire a full-time KFBM Program Coordinator.
2. Develop a mission statement and set of policies that specifies the intent and purpose of KFBM, including operational guidelines and accountability.
3. Evaluate the potential and strategy for program growth even if UK funds are fixed at current levels.
4. Plan for timely publication of the annual summary, enterprise studies, newsletters, and other publications and if this cannot be completed, then they recommend the College reduce its cost-share role.
5. Improve the profile of KFBM within the Extension System.

I am pleased to report that a committee made up of Colby Blair, Brian Lacefield, Craig Gibson, Dave Heisterberg, Will Snell and me are busily working to implement all nineteen recommendations. Here is the status of the five recommendations listed above.

1. A candidate for the Program Coordinator position has been interviewed and an offer is pending.
2. A mission statement and some operational guidelines are being drafted and circulated.
3. A strategy for program growth is planned as part of a statewide plan of work built on specialists' plans of work.
4. The key to timeliness has been determined to be that of making averages of our data available early in the spring.
5. The profile of KFBM will be heightened by more participation in key meetings around the state. This effort will be led by the new Program Coordinator and will include attendance by specialists and departmental faculty representing KFBM.

I hope this information was interesting to you and answered a few questions. It has probably generated a few more. Please, if you have questions or concerns, speak with your KFBM Specialist, contact Will Snell or me. Future issues will keep you updated on the status of implementing the recommendations.

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**Have a safe harvest!**

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