

False Reform:

An analysis of Congressional payment limits proposals in the 2007 Farm Bill

Center for Rural Affairs
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Introduction

Farm program payment limitations have been the single most controversial issue of the entire 2007 farm bill process.

The most far reaching proposal to tighten farm payment limitations – the Dorgan Grassley proposal – was not adopted in by either the House or Senate Agriculture Committee. It was considered by the full Senate and defeated, falling four votes short of the sixty-vote super-majority requirement imposed on the amendment by Senate leadership.

Nonetheless, House and Senate Agriculture Committee leaders each claim the farm bill they developed represents significant payment limitation reform by virtue of eliminating the “three entity rule” and instituting “direct attribution” – the practice of attributing farm payments received by entities to the payment limitations of their owners. In fact, several leading proponents of the bill’s payment limit provisions have called it “historic” and “the biggest reform measure of all time”. The purpose of this analysis is to determine the impact of eliminating the three entity rule and instituting direct attribution of farm program payments.

Background

Direct payments are paid on historic “base acres” and made each year regardless of commodity prices. They are currently forecast to account for 75 percent of all commodity program expenditures over the life of the farm bill because high commodity prices are expected to minimize the countercyclical and loan deficiency payments made to offset low market prices.

Under current law the nominal limit on direct payments is \$40,000. However, recipients can receive double that amount (\$80,000) in one of two ways - the "spouse rule" or the three-entity rule.

The three entity rule allows an individual to collect \$40,000 from one business entity in which he/she owns 100 percent interest and up to \$20,000 from each of two separate entities in which he/she owns up to 50 percent interest, for a total of \$80,000. The spouse rule accomplishes the same feat, allowing married farm program payment recipients to double their limit to \$80,000 by each qualifying individually for \$40,000.

To qualify for the spouse rule, only one spouse needs to meet all the criteria for being actively engaged in farming. The second spouse can qualify by participating in discussion of at least one important farm decision each year.

Current law prohibits farm couples from using both the three entity rule and the spouse rule. They must choose one or the other. Thus they can receive only \$80,000, but they have two alternative ways of receiving double the nominal \$40,000 limit.

The House and Senate versions of the new farm bill eliminate the three entity rule and institute “direct attribution” – the practice of attributing farm payments received by entities to the payment limitations of their owners. The Senate bill leaves the nominal direct payment limitation at \$40,000. The House bill increases the nominal limit to \$60,000.

Both bills would allow married farmers now using the three entity rule to switch to the spouse rule to continue receiving more than the nominal limit. Most of the affected married farmers will likely use that option, and thus face no reduction in payment. Under the Senate bill they would be eligible for the same \$80,000 as current law provides, while under the House bill the effective direct payment would increase to \$120,000.

We undertook this analysis to determine how many direct payment recipients currently using the three entity rule are in fact married, and thus likely unaffected by the House and Senate farm bill provisions instituting “direct attribution” and eliminating the three entity rule. In addition, we analyzed how many recipients would get even bigger payments as a result of the increase in the direct payment limitation in the House bill.

Methodology

Using data obtained from the Environmental Working Group, a list was compiled of all individuals receiving more than \$40,000 in direct payments, directly and through legal entities, for the 2005 crop year in seven states (Georgia, Iowa, Kentucky, Minnesota, Montana, North Dakota, and Oklahoma).

The Environmental Working Group compiled the data from the most recent United States Department of Agriculture database, which for the first time directly attributes payments through multiple entities to individual farmers (commonly referred to as the “1614” database, after the provision of the 2002 farm bill which required the publication of this information).

The Center for Rural Affairs is wholly responsible for the analysis contained within this paper. We are indebted to the Environmental Working Group for providing the raw data.

Utilizing public records in combination with phone surveys, information was compiled on the marital status of these farm program payment recipients. Specifically, a phone records search was undertaken for joint listings of married

couples. If the recipient had a joint phone listing with another person, we concluded that he/she was married.

Next, a phone survey was conducted of remaining individuals to ask their marital status. Through these efforts, information on marital status was obtained for 62% of individuals receiving more than \$40,000 in direct payments for the 2005 crop year.

Finally, to determine the number of recipients who would enjoy a payment increase under the House Bill, we identified pairs of spouses together receiving the maximum \$80,000 payment. We assumed that two individuals, each receiving \$40,000 and each with the same nine digit zip code were spouses unless their names were clearly of the same gender.

State	GA	IA	KY	MN	MT	ND	OK	Total
Number of Individuals Receiving Greater Than \$40,000 in Direct Payments, 2005	439	99	40	62	49	55	72	816
Number of individuals with a determined marital status.	259	74	22	38	29	41	40	503 (62%)
Number of individuals married. (Percentage)	255 98%	73 99%	22 100%	37 97%	29 100%	40 98%	40 100%	496 99%
Number of individuals facing a reduction under the Senate Farm Bill	2	1	0	1	0	1	0	5
Number of individuals facing a reduction under the House Farm Bill	0	0	0	0	0	0	0	0
Number of farms expected to receive increase under the House Farm Bill	1	28	2	10	8	21	3	73

Results

As presented in the table above, 97% to 100% of farmers in each state with an identified marital status are married. In Kentucky, Montana and Oklahoma we found no unmarried farmers currently receiving more than the nominal limit, while in other states 1-3% of farmers identified were determined to be unmarried. For all seven states, we identified five farmers – one percent of farmers for whom we could determine marital status – who are unmarried and likely to face a payment reduction as a result of Senate bill provisions eliminating the three entity rule and instituting direct attribution of payments.

Under the House farm bill, even fewer farmers will be affected because the direct attribution is offset by the increase in the nominal payment limitation from \$40,000 to \$60,000. Among the farmers for whom we could determine marital status, we identified none in the seven states who currently receive more than \$60,000 and would thus face a payment reduction under the House bill.

However, we found 73 farmers in the seven states who would get even bigger payments under the House bill than they receive under current law. These are married farmers who, together with their spouse, are currently limited to \$80,000. They would receive more than \$80,000 under the House bill, which raises the limit to \$120,000 for married couples.

Direct payments paid on peanut base acres have a separate limit from those paid on corn, cotton, rice, soybean and wheat acres, which lowers the number of farms expected to receive an increase under the House-passed farm bill. The peanut farms in the analysis already receiving \$80,000 in direct payments (or more) as a result of combining the limits on peanut direct payment and the limit on other program crops will see no change in payments under the House farm bill.

Conclusion and Recommendations

The findings indicate that eliminating the three entity rule and instituting direct attribution of payments, as proposed by the House and Senate farm bills, would do little to reduce direct payments to the nation's largest farms. In fact, the House bill would increase payments to the largest farms. Under the Senate bill, the vast majority of farmers currently utilizing the three entity rule to double the nominal payment limit would simply achieve the same result through the spouse rule.

Thus both bills would continue three adverse impacts of large federal farm payments to the nation's largest farms:

- 1) The federal government would continue to subsidize the nation's largest farms to bid land away from smaller operations, resulting in farm consolidation and reduced farm opportunity;
- 2) The aggressive, expansion-oriented large farms that typically drive land price trends would have continued incentives to bid farm payments into higher cash rent and land purchase prices, thereby increasing cost of production for all farmers and frustrating the farm program objective of increasing incomes of farm operators; and
- 3) Federal expenditures on payments to large farms would not be significantly reduced, frustrating Congressional efforts to reduce such expenditures.

Supporters of the House and Senate-passed farm bills cite reductions in the Adjusted Gross Income (AGI) test for farm program eligibility as significant reform. (A lower AGI limit is also a defining feature of the Administration's farm bill proposal). The AGI test is not a payment limitation. Rather it is a means test that denies eligibility for payments to certain high income recipients.

Last week, Senator Chuck Grassley (R-IA) released analysis of U.S. Internal Revenue Service data related to the AGI limits in the various farm bill proposals. He wrote:

In 2005, the U.S. Department of Agriculture made over \$230 million in payments to landlords and farm operators who exceed the income limits in the House farm bill and over \$137 million to those exceeding the Senate bill limits. However, projections by the Congressional Budget Office (CBO) suggest that most of those recipients will continue to receive payments. The modest savings projected by CBO suggest that 83 percent of the funds paid to recipients exceeding the House limits would continue to be paid and 95 percent of the funds paid to recipients exceeding the Senate limits would continue to be paid.

I had the opportunity to analyze this data and would like to share what I believe this data indicates. . . . Recipients of farm commodity payments with high incomes will use 3 loopholes and legal means to avoid the AGI limits.

First, 36 percent of those who would lose farm payments under the Senate AGI limit, 37 percent who would lose farm payments under the House limit, and 41 percent under the Administration limit, are *share* rent landlords. Those landlords will want to keep farm program payments flowing and will change to cash rents, thereby shifting risk and capital requirements to farmers.

Secondly, high income farmers will reinvest income into expanding their operations. This will generate deductions to keep their taxable incomes below the limits and converting taxable income to untaxed wealth.

Finally, I believe that high income farms will divide income between spouses and where applicable, the farm corporation, to stay below the limits.

As a result, most payments will continue to be made to high income recipients in spite of the proposed limits under both the Senate and House versions of the farm bill.

Ultimately, Senator Grassley's analysis, in combination with the data presented here, demonstrate the complete ineffectiveness of the so-called "reform" measures in the House and Senate-passed farm bills. Removing the three-entity rule, implementing direct attribution, and tinkering with AGI limits may well be necessary steps, but taken on their own will do little to save money, reduce capitalization of farm program benefits into land prices or enhance farm opportunity by targeting farm program benefits to small and mid-sized farmers.

Those objectives cannot be achieved by means tests alone or by piecemeal payment limitation reform that closes one loophole but leaves others open. Effective reform must be comprehensive reform, such as the proposal of Senators Byron Dorgan and Chuck Grassley.

Means tests based on AGI limits are not the complete answer. They will never be effective in reducing subsidies to mega farms to drive smaller operations from business. AGI limits do have a role to play in reducing payments to high income investors, but they can only be effective if payments are denied or reduced on *land owned by the rich*. Otherwise, high income land owners will continue to enjoy the benefits of full farm payments through lucrative cash rental arrangements.

Supporting family-scale farming has long been a stated goal of farm programs. That goal has broad support among farmers and all Americans. Properly targeted farm programs can enhance family farm opportunity and rural community vitality.

However, the House and Senate-passed farm bills fail to advance that goal. Their so-called reforms are illusion – political cover for failure to adopt true reform. In reality, they continue to subsidize the destruction of family farming and the agricultural communities of rural America.