

## 1996 Cotton Management Economic Notes

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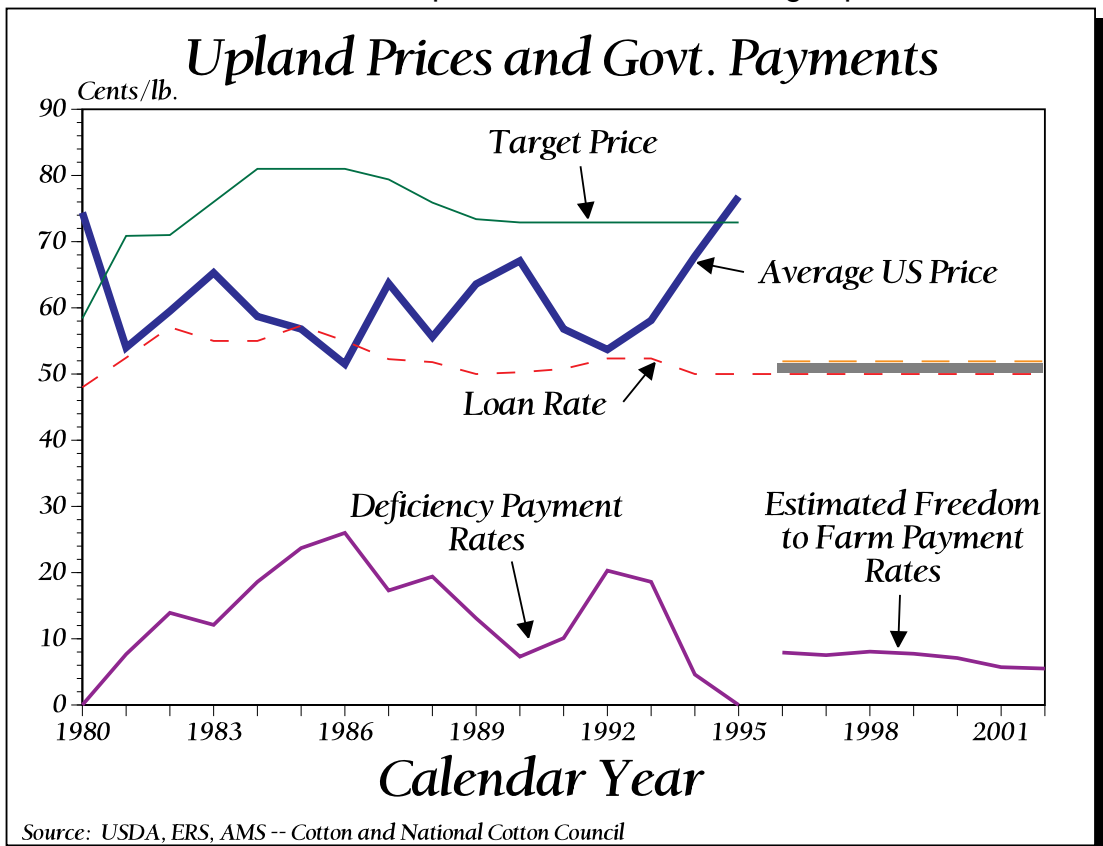
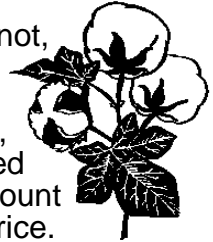
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### New Farm Legislation: An Early Assessment

Farmers who participated in the federal wheat, cotton or feed grain programs during any one of the last 5 years can enroll in the new program for 1996. Signup will be available from 20 May through 12 July. Most of Arizona's commercial farmers will be eligible and should find participation in the new program to their benefit with fewer strings attached to payments.

The new program, entitled the Federal Agricultural Improvement and Reform (FAIR) Act, differs sharply from previous programs. Participating farmers will have much more freedom to plant crops and acreages

of their choosing, but they will not, in general, be protected against low prices as they have been in the past. When prices declined, payments automatically increased in direct proportion to the amount prices fell below the target price.



Source: USDA, ERS, AMS -- Cotton and National Cotton Council

### Recent Prices

	April 1, 1996	
	Upland (¢/lb)	Pima (ELS) (¢/lb)
Spot - uncompressed	82.03	161.00
May '96 Futures	84.78	
Dec '96 Futures	79.82	
Dec '97 Futures	78.18	
Adj. World Price	68.20	

Note: Upland Spot for Desert SW grade 31-3, staple 35, add 300 points for compressed bales, Pima Spot for DSW grade 03, staple 46, 3/21/95. Adjusted World Price for 3/29/96.

The new "transition payments" will be based on historical program acreage and yield, but are no longer determined by average annual US prices. In the terms of the day, farm program payments have been "decoupled" from current production decisions and market conditions.

The figure above shows upland prices since 1980 and how past deficiency have varied. The "deficiency payment" line is simply the difference between the target price and average US price. This overstates actual payments for each pound of cotton produced since program

## Estimated Production Costs

### \$/lint lb (1994-95 Field Crop Budgets)

The following table gives estimated production costs/lb. These costs include both cash and ownership costs that are based on the displayed target yields. Producers with higher yields will have lower costs/lb if input costs are the same. Growers with lower yields will have higher costs/lb.

County	Target Yield	Cash Operating Costs	Ownership Costs	All Costs
Cochise	660	.69	.43	1.12
Graham	1,000	.42	.32	.74
Greenlee	900	.48	.33	.81
LaPaz	1,300	.50	.30	.80
Maricopa	1,200	.44	.23	.67
Mohave	1,100	.42	.22	.64
Pima	1,100	.45	.24	.69
Pinal	1,200	.53	.30	.83
Yuma	1,250	.49	.26	.75

Note: Based on Wade, Daugherty, et al., "1994-95 Arizona Field Crop Budgets", Various Counties, Arizona Cooperative Extension, Tucson, March, 1994.

yields have been fixed since 1985 and flex acreage introduced in the 1990 farm bill have reduced deficiency payments by at least 15% from the 1985 bill. Still, the mirror image illustrates how government payments cushioned price declines on a large portion of cotton production.

Direct payments for cotton under FAIR are estimated (National Cotton Council) to decline from around 8.0 to 5.5 cents per pound from 1996 through 2002. Under the new law, payments will probably be higher, at least in 1996, than they would have been under the old program. This occurs because most market watchers expect market prices for cotton, wheat and feed grains to be relatively high in 1996, and high prices under the old program reduced deficiency payments. Payments under the new law, based on historical program participation, will phase down over the next 7 years, and then are scheduled to end. Although the new payments do not affect the relative profitability of cotton, wheat, or grain farming, they do increase available cash to the farmer and may improve credit-worthiness for production loans.

### Non-Recourse Loan

The new program also provides, as did past programs, for nonrecourse marketing loans for upland, ELS, feed grains and wheat. Although the relatively low loan rate on each crop will not likely serve as protection against low crop prices, at least in 1996, this part of the program does continue to offer a low floor of price protec-

tion. The loan rate for upland will not be less than 50¢/lb. and not greater than 51.92¢/lb. The loan rate for ELS can not exceed 79.65¢/lb. As before, payments are limited to a maximum of \$75,000 per person for marketing loan and loan deficiency payments. Total transition payments are limited to \$40,000 person, down from \$50,000 for deficiency payments.

### Production Costs

The table to the left provides cost-of-production information by county using estimates from the University of Arizona 1994-95 Field Crop Budgets. The loan rate provides price protection which covers cash operating costs of production for most counties. These costs include land preparation, growing, harvest, and post harvest activities. Any returns over cash operating expenses represent funds available to pay overhead, land expenses, ownership expenses, and management services plus profits. In the long term all costs must be covered. If cotton prices drop below 60¢/lb. as in the early 90s, land that has no better economic alternative will drop in value more under the new law than under prior legislation. Land and market prices that are unable to cover all cash operating expenses will be taken out of production.

### Some Implications

For farmers, the new law has several important implications for production and marketing. Farmers, and their credit institutions, must now base expected crop returns on what they anticipate market prices will be, rather on the guaranteed target price of the 1990 farm legislation. The new farm program allows producers to switch crop acreage into crops perceived to be more profitable. But a lack of any price protection through target prices and deficiency payments is an added price risk. To reduce this risk, farmers may want to forward contract or hedge part or all of their crop with futures and options.

Although the new program does increase planting flexibility because it eliminates the former base acreage restrictions and acreage reduction programs (ARPs or set-aside acreage), program participants can not plant fruits and vegetables on contract acreage (land in the commodity programs in past years) unless the farm meets provisions provided for historical double cropping. ELS is not considered a contract crop and contract acreage can be planted to alfalfa.