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The Agriculture Letter

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Dear Client: Washington, Oct. 8, 2021

Climate-smart commodities plan…
Your comments are being requested…
But ag secretary insists it is not a carbon market.

CLIMATE PLAN

Climate-Smart Agriculture and Forestry (CSAF) Partnership Program… linking back to an executive order on the topic from President Joe Biden.

Comment period is only 30 days… but that is very likely to be extended.

USDA Sec. Tom Vilsack spins the plan. He insists this is not a carbon market: "This initiative is not a carbon bank, nor a carbon market. It's not even a conservation program."

It's "first and foremost a commodity program," Vilsack says. "One that seeks to empower farmers, ranchers, producers & foresters to produce climate-smart commodities, meeting domestic and global consumer demand."

Carbon sequestration is mentioned in a Federal Register notice, so Vilsack's insistence may not be so convincing. The term "climate-smart commodity" is used to refer to an agricultural commodity that is produced using farming practices that reduce greenhouse gas (GHG) emissions or sequester carbon.

CCC could be tapped. Issue: whether USDA's Commodity Credit Corporation (CCC) authority could be used to fund the plan. USDA said a program "could be developed" under CCC authority. Vilsack said a commodity program, and one that helps promote markets and exports, could tap CCC to fund this effort. "And if they are used, they will be at a significant level that will allow us to accomplish the purpose of this initiative without compromising CCC's other important role… to support farm bill programs and emergency needs."

Republicans in Congress question whether USDA has authority to use CCC for a carbon bank. Sen. John Boozman (R-Ark.), ranking member on the Senate Ag Committee, wants Vilsack to come before the committee to explain all this.

Opportunities could include "markets for low-carbon biofuels and renewable energy," USDA said. "Agricultural producers and landowners also have opportunities to market GHG reductions generated as a part of climate-smart commodity production."

'Benefits' a code word for carbon credits? USDA noted there are "barriers" that have kept markets for climate-smart commodities from "reaching scale," including the lack of a standard definition of climate-smart commodities. But others include a "lack of clear standards for measurement of climate benefits of CSAF practices," and the "potential for double-counting benefits." USDA also noted things like "high transaction costs," the "limited ability for small producer participation," the lack of "efficient supply chain traceability," and the "high risk of market entry" as being barriers.

Key CSAF Topics

"How might the U.S. gov't encourage CSAF practices by leveraging private-sector demand and providing new income streams for farmers, ranchers, and forest landowners?"

"How would existing private sector and state compliance markets for carbon offsets be impacted from this potential federal program?"

Examples: "Activities that develop standardized supply chain accounting for carbon-friendly products; activities that provide supply chain traceability; innovative financing for low-carbon fuel from ag feedstocks; or green labeling efforts, among others." What about early adopters?

USDA said it could "make more sense to work with groups of producers and landowners" such as producer associations, state/tribal/local governments, farmer cooperatives, carbon offset project developers, conservation districts, institutions of higher education, which could include cooperative extension.

Source: Federal Register notice

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Subscription inquiries: 888-752-2047 or AgricultureLetter@farmjournal.com
Editorial information: Tel., 800-772-0023; Fax, 319-277-7982;
E-mail: aglettereditors@farmjournal.com; or website, AgricultureLetter.com

WHIP+ <u>Congress passes Continuing Resolution with WHIP+ extension and improvements</u>. The House and Senate last week approved a stopgap funding bill to keep the gov't open through Dec. 3. Signed by Biden, it includes $275 mil. for watershed and flood prevention operations (WFPO) at the Natural Resource Conservation Service (NRCS), $10 bil. for an extension and improvements to WHIP+, including $750 mil. for livestock affected by drought, as well as an extension of authority for USDA's mandatory livestock price reporting system.

<u>Ag disaster funding details</u>: It covers losses in 2020 and 2021 of crops… including milk, on-farm stored commodities, crops prevented from planting and smoke-tainted grapes… caused by a wide range of disasters across the country including drought, wildfire, hurricanes, floods, derechos, excessive heat, winter storms, freeze, including a polar vortex, smoke exposure, quality losses of crops and excessive moisture. Counties experiencing severe drought (D2) or worse for eight consecutive weeks qualify.

<u>Yearly payment limit is $125,000</u>. However, if at least 75% of a producer's adjusted gross income (AGI) is derived from farming, ranching or forestry-related activities, the per-year payment limit is increased to $250,000. Specialty crop producers deriving at least 75% of their AGI from farming, ranching or forestry-related activities will have a payment limit of $900,000.

CAP GAINS <u>Some harmful tax changes still in reconciliation bill</u>. The *Wall Street Journal* reports proposed changes to capital-gains taxes have good news for some of the highest-earning Americans and bad news for those earning between $400,000 and $1 million. The House Ways and Means Committee reconciliation proposal of a 28.8% rate would kick in at $400,000 of taxable income for single filers and $450,000 for married joint filers. That is around $50,000 below the thresholds for the current 23.8% top rate, which are $445,851 for single filers and $501,601 for married joint filers.

<u>This is bad news for people with income in the $400,000 to $1-mil. range</u>, even if it is from a one-time windfall like the sale of a home or business… or farm. For many sellers of small businesses, including farms, the rate on part of their gain would rise to 28.8% from 15.0%.

<u>Important caveat</u>: Tax changes could still significantly change in any final Democrat-written package. They all depend on the final price tag for spending and how much of that tab is truly offset.

LIVESTOCK <u>More time for livestock operators in 36 states to defer gain</u> on sales due to severe drought. Farmers in counties on IRS' list of areas still suffering from drought may defer gain until at least the end of 2022 by buying replacement livestock… even if the normal four-year period for gain deferral on drought-related sales has lapsed.

<u>Time period</u> will run until the end of the filer's first tax year after the county drops off the agency's list… check IRS Notice 2021-55 for details.

U.S./CHINA TRADE <u>China goofed up on its Phase 1 accord with U.S.</u> How? The country would not be so lacking in energy supplies had it followed the energy purchase commitments in Phase 1. According to the Peterson Institute for International Economics, China's energy purchases at $12.6 bil. represented only 56% of the seasonal targeted rate. In contrast, it reached 92% of its seasonal targeted rate for ag products of $43.6 bil. this year. China was too focused restoring depleted grain supplies and got caught short-bought on energy needs.

<u>China ordered its state-owned companies to secure energy supplies at all costs</u>, including ordering coal producers to run at full speed, even if they exceed annual quota limits. That news pushed natural gas and power prices to record highs in Europe.

<u>China's soybean crushing plants feeling the pain</u>. At least 50% the soybean crushing plants in northern and northeastern China have been shuttered due to the country's power outages, *Reuters* reported.

<u>Feed costs are spiking higher as a result, compounding troubles for hog farmers</u> who are already struggling with poor margins.

DEBT LIMIT

Treasury Sec. Janet Yellen says the real debt limit will be hit Oct. 18.

Yellen said the current debt ceiling law can prove "very destructive" by creating a legal debt limit that has to be raised separate from what Congress has already ordered the federal gov't to spend. Yellen, asked by a member of the House Financial Services Committee if the damage done by failure to meet the federal government's debt obligations would be "irreparable," replied, "Yes."

Why do Democrats insist on *suspending* the debt and why not link it to reconciliation? Sources say that although it has not been tested, it appears that if the debt limit language is included in reconciliation, a specific dollar figure must be included. If so, sources signal the Congressional Budget Office puts the likely debt limit figure at $35 trillion. Democrats do not want a specific debt limit figure, knowing they will be the only votes for the matter via reconciliation.

Around $80 bil. of payments to Social Security recipients, veterans and active military personnel are due on Nov. 1 and could be delayed.

MARKETS

Fertilizer: Ripple effects from soaring fertilizer prices threaten to squeeze already tight grain supplies. Higher crop-nutrient costs worldwide, spurred by energy crises in Europe and China, could cause farmers to switch from corn and wheat to other less fertilizer-intensive plants, adding pressure on already tight stockpiles, Alex Sanfeliu, head of Cargill Inc.'s World Trading Group, told *Bloomberg*.

U.S. inflation hits 30-year high: Inflation as measured by the Personal Consumption Expenditure price index rose 0.4% in August, putting it up 4.3% on an annualized basis… highest level since 1991. Minus energy and food, prices rose 0.3% during August, while the annual rate at 3.6% was also a 30-year high.

Corn: Sept. 1 corn stocks topped expectations, but futures took the bearish data in stride, partly because of strength in the wheat market.

Soybeans: Sept. 1 bean stocks were more than 80 mil. bu. higher than traders expected. That changes the price outlook, especially if USDA increases its crop estimate on Oct. 12. With 2020-21 soybean ending stocks now in the "comfort zone" above 200 mil. bu., *Pro Farmer* analysts say it will be difficult to build upside momentum without a South American weather/crop scare or a strong pull from other markets.

Wheat: Futures rallied as USDA's final crop estimate pulled Sept. 1 stocks lower than expected to a 14-year low… why corn is now following wheat for a change. This will likely lead to lower wheat feeding ahead. Focus now is on international production prospects.

Cotton: With futures surging over $1, producers should lock in some coverage.

Hogs/pork: USDA's latest Hogs & Pigs report recharged market bulls, with the hog herd coming in much lighter than expected and the much smaller summer pig crop (down 6.0%) and the 3.1% reduction in breeding herd signaling the U.S. hog herd will continue to contract. But there is the potential for a black swan event: The U.S. Coast Guard is scrambling to keep African swine fever (ASF) from washing ashore in Puerto Rico and potentially shutting down America's pork exports. The Western Hemisphere registered its first outbreak of ASF virus in almost 40 years on July 28 at pig farms in the Dominican Republic. By September the devastating disease had been found in neighboring Haiti. Big concern: Puerto Rico is experiencing a dramatic rise in undocumented migrants from ASF hot spots. While Puerto Rico is more than 2,200 miles from the hog farms of Iowa, it's part of the U.S.

Cattle/beef: Futures have weakened, led by feeder cattle, which posted a downside breakout from the recent consolidation range. Demand for beef is a growing concern.

Transportation: U.S. port backlog is peaking, but impacts will linger. Rates for shipping by truck continue to climb, notably for west-east traffic. Even ports in N.Y. and N.J. are seeing ships waiting. Warehouses are crammed. A pilot program offering 24-hour container operations at southern California ports hasn't attracted any truckers more than two weeks since it began. Terminal operators say many slots for container pickups are going unused at all times of the day, even as container ships continue to line up offshore.

CONGRESS Nine centrist House Dems vs. 96 progressives (liberals). Guess who "won" the latest battle and which group Biden favored? The losers were those trying to force a vote on the bipartisan infrastructure (BIF) bill. The winners of no funding were the liberals. The partial losers were House Speaker Nancy Pelosi (D-Calif.), who now can't follow through on her vote pledges, and in a sense, Biden. Centrist Sen. Krysten Sinema (D-Ariz.) released a blistering statement, slamming the delayed BIF vote as "inexcusable" and "deeply disappointing," adding it will reduce trust within the party.

Pelosi's latest deadline: Oct. 31. In a "Dear Colleague" letter, Pelosi said "more time was needed" to pass the bipartisan infrastructure bill along with the larger social and climate change package (Build Back Better/BBB). The Speaker said she wants to pass the bipartisan bill by Oct. 31, when the 30-day recently extended reauthorization of federal highway programs expires. "There is an Oct. 31 Surface Transportation Authorization deadline, after passage of a critical 30-day extension," Pelosi wrote. "We must pass well before then... the sooner the better, to get the jobs out there."

Artificial deadlines? Asked whether the deadlines to pass both spending measures were artificial, Sen. Bernie Sanders (I-Vt.) told Meet the Press: "Of course they are."

Tax deadline. Biden said he believed the legislation would be signed into law with "plenty of time to change the tax code for people next year."

Grueling choices ahead. Democrats and White House officials must now decide how much and where to shave the BBB — whether to axe certain plans entirely, or just shrink initiatives across the board. Even spending around $2 tril. will displease some. Sanders was realistic regarding the eventual price tag of any completed BBB, telling *ABC's This Week*: "What the president has said is that there's going to have to be some give and take, and I think that that's right. I think if anything, when we especially talk about the crisis of climate change and the need to transform our energy system away from fossil fuel, the $6 tril. that I originally proposed was probably too little. Three and a half tril. should be a minimum, but I accept that there's gonna have to be give and take."

Pelosi's liberal leader comments. Congressional Progressive Caucus Chair Pramila Jayapal (D-Wash.) said the following regarding the prospect of a $1.5 tril. reconciliation bill on *CNN's State of the Union*: "Well, that's not going to happen... Because that's too small to get our priorities in. So, it's going to be somewhere between $1.5 [tril.] and $3.5 [tril.], and I think the White House is working on that right now, because remember, what we want to deliver is childcare, paid leave, climate change, housing."

AG ISSUES There are many unknowns for ag that hinge on how the spending issues unfold:

• Traditional infrastructure: There is wide bipartisan support for the around $1 tril. in the bipartisan infrastructure measure, but it's linked with the outcome of the coming battle on social policy and climate change funding.

• Tax changes: Looks like stepped-up basis will survive, but tax experts are still cautious and note other tax changes dealing with capital-gains could impact the ag sector... *see page two for details*.

• $28 bil. in conservation spending will likely be part of any final package.

• Changes in 1031 land exchanges will likely not be part of any final plan.

• Billions of dollars in loan forgiveness is currently in the package, designed to get around court challenges. Producers classified as "economically distressed" could qualify for payments equal to their entire debt on USDA loans. Loan payoffs for other producers would be capped at $200,000. Bill would also provide $1 bil. to USDA to adjust loans.

Best regards,

The Ag Letter Editors

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