



# ECONOMICS COMMENTATOR

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## Fiscal Stimulus

by

Bill Adamson  
Associate Professor

The economy appears to be on the cusp of a recession. Triggered by instability in the sub-prime home mortgage market in August, average home prices began to fall. Home equity is a primary source of household wealth—primarily for middle class families. The negative wealth effect resulting from the drop in average home prices nationwide has negatively impacted consumption. Retail sales declined over the fourth quarter and unemployment rose to 5.0% in December. Consumer confidence fell dramatically in December and the most ominous trend is the loss of 17,000 jobs in January. While the US is not in an official recession, the data suggests that the economy is on the brink of entering one. Preliminary fourth quarter Gross Domestic Product (GDP) estimates have real economic growth slowing to 0.6%. The economy has slowed considerably from the 4.9% real growth rate in the third quarter. Generally, six consecutive months of negative GDP growth constitutes the beginning of a recession (technically, the National Bureau of Economic Research (NBER) Business Cycle Dating Committee officially determines the timing of economic recessions and recoveries).

Macroeconomic policymakers have been looking to stimulative policies to stave off the onset of a recession or minimize the down. The Federal Reserve System cut the target range on the federal funds rate (the interest rate banks charge other banks for the overnight lending of reserves) from 4.5% to 3.5% and cut the discount rate (the interest rate on reserves borrowed from the Fed) by 0.75% to 4.0% (*Fiscal Stimulus ... Continued on page 2*)

## 2008 SDSU South Dakota Farm Real Estate Market Survey

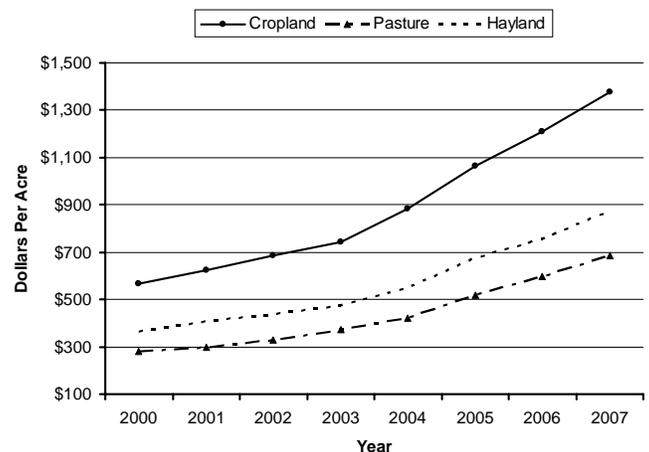
by

Burton Pflueger  
Professor / Extension Specialist

The Department of Economics is conducting the 2008 SDSU South Dakota Farm Real Estate Market Survey. This will be the 18th SDSU survey developed to estimate agricultural land values and cash rental rates. Survey results provide information to farmers and ranchers, landowners, agricultural professionals, and policy makers interested in land market trends. This newsletter highlights important findings of past surveys and encourages recipients of the survey to respond quickly – your responses are very important!

Based on SDSU survey results, graphical presentation of statewide averages of cropland, hayland, and pastureland land values and cash rental rates are shown in Figure 1 (below) and Figure 2 (on page 3).

**Figure 1. South Dakota Agricultural Land Market Trends Land Values**



(2008 Farm Real Estate ... Continued on page 3)

**(Fiscal Stimulus ... Continued from page 1)**

on January 22<sup>nd</sup>. This was an emergency move that occurred before the Federal Open Market Committee (FMOCC) meeting on January 30<sup>th</sup>, when most rate cuts are announced. The Fed followed their emergency move with another 0.5% federal funds rate cut to 3.0% at the FOMC meeting. The moves were intended to provide sufficient reserve availability to the US banking system to stabilize domestic financial markets after global markets in Asia, Australia, and Europe dropped by 5% to 10% the day before the emergency rate cut. The Fed's expansionary monetary policy appears to have stabilized US and global markets, but the Fed is clearly concerned that a future recession may be on the horizon since the Federal Funds target-rate has fallen by 2.25% since August.

The fear of an economic downturn, especially before the 2008 presidential election, has policymakers responding with a fiscal stimulus package. A stimulus package proposed by the Bush Administration and passed by the House provides \$150 billion in tax cuts and increases in federally subsidized home mortgage loan limits. The tax cuts provide rebates of \$300 to \$600 for individuals making up to \$75,000 and up to \$1,200 for married couples making up to \$150,000. Individuals making more than \$75,000 and couples making more than \$150,000 receive a decreasing percentage of full tax rebate and partial tax benefits end for individuals with incomes over \$87,000 and for couples with incomes over \$174,000. Businesses receive a temporary increase in allowed depreciation on the cost of new equipment expenditures in 2008. Loan limits on Fannie Mae, Freddie Mac, and FHA home mortgages increase from around \$400,000 to \$729,750. Households will receive the tax rebates around May or June, after the filing of 2007 taxes.

The fiscal stimulus package has been criticized in that it helps primarily higher income households at the expense of those less-well-off. Experience from the 2001 tax rebates resulted in only about half of the tax cut being spent, primarily on nondurable goods. The rest was saved. Typically very little of a tax cut is spent on durable goods since expenditure on consumer durables falls in a recession (unlike nondurable goods, purchases of durable goods can be delayed). Critics (primarily in the Senate) argue that the best stimulus package would target low income

households who would more likely spend any tax or income transfer benefit, rather than save it. This faction argues that any tax rebate should be accompanied with an extension of unemployment insurance benefits, an increase in food stamp allotments, and an extension of the tax rebates to seniors and disabled veterans (households who typically would not meet the earned income threshold of \$3000 needed to qualify for tax rebates under the House plan). The tax stimulus package passed after a concession to the Senate that allows households with Social Security or veteran's disability benefits of at least \$3000 to receive a \$300 tax rebate. This adds about \$20 billion to the cost of the stimulus package (or rather, it adds an additional \$20 billion to the FY2007 deficit).

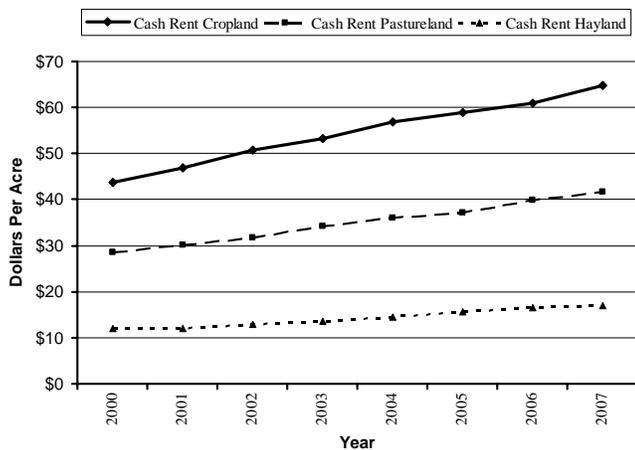
A number of economists, and I would agree with them, argue against any fiscal stimulus. At best, a fiscal stimulus will only marginally help an economy that suffers from a long-run structural problem of unprecedented levels of debt for households, businesses and government. The critical underlying problem is the personal saving rate near zero (households are consuming nearly all of personal disposable income). If anything, the proposed tax-cut package is likely to exacerbate the fundamental problems of an economy challenged by unsustainable consumption financed by increasing indebtedness. The projected federal budget deficits for FY2008 and FY2009 are over \$400 billion. These estimates are based on an assumption of 2.7% GDP growth rate and \$70 billion for the funding of war operations in Iraq and Afghanistan through FY2009. These are rather optimistic assumptions given that GDP growth in 2007 was 2.2% and the Blue Chip Consensus forecasts economic growth at 2.4% while Citigroup forecasts growth at 1.4% and expects a "mild but prolonged" recession to develop in 2008. Iraq and Afghanistan war operations have been averaging \$12 billion a month which would put war operations expenditure well over \$70 billion unless there are dramatic changes in current war operations. The total national debt is \$9.2 trillion. By the end of FY2009, the national debt will be over \$10 trillion—given current deficit projections.

The stimulus package represents a short-term fix that fails to address the long-term problems of the

US economy. We will have to finance the additional debt by borrowing from foreign investors because of the low US personal saving rate. The increased foreign borrowing further increases US international indebtedness. Our net international investment position was -\$2.5 trillion in 2006. Increasing international indebtedness will increase the risk premium on US denominated securities and put further downward pressure on the US dollar. A depreciating dollar will put increased cost pressure on imported natural resources critical to the US economy—such as crude oil, and will only add to the recent inflationary pressures (the CPI inflation rate was over 4% for November and December of 2007). As the US economy teeters on the precipice of a recession, I would agree with many other economists that rather than a fiscal stimulus that encourages increased consumption at the expense of increased debt, federal economic policy should encourage savings and investment.

*(2008 Farm Real Estate ... Continued from page 1)*

**Figure 2. South Dakota Agricultural Land Market Trends Cash Rent**



A major purpose of this survey is to solicit expert opinion of land values and cash rental rates by major uses of privately owned agricultural land, excluding farm building sites. The major non-irrigated land uses reported are crops, hay, tame pasture, and rangeland. Rangeland is native grass pasture while tame pasture is seeded to introduced grasses. Agricultural land typically used for production of alfalfa hay, other tame hay, or native hay is considered hayland in this survey. Cropland is agricultural land typically used

for crop production other than hay production. Since most irrigated land in South Dakota is used for crop or hay production, the survey solicits information on the value and rental rates of irrigated land used for these purposes. These major land uses comprise nearly 98% of privately owned land in farms in South Dakota (Janssen 1999). Results of the 2008 SDSU Farm Real Estate Market Survey will report on the results of the survey and also include a discussion of factors influencing buyer/seller decisions and of positive/negative factors impacting farmland markets. **It is important that recipients of the survey return their response so 2008 values can be calculated and land market trends examined.**

South Dakota land values and cash rental rates are influenced by changing economic conditions in South Dakota agriculture. The 2008 survey will assist the Department of Economics in their analysis of how current commodity process may be influencing land values and cash rent rates.

Most renters, buyers, and sellers of farmland continue to be local area residents, although there is greater outside interest in recent years. Many of the influential factors are related to changing economic conditions in agriculture. Land markets tend to reflect these changing economic conditions as land market participants adjust over time to current and prospective conditions. Land market trends usually lag behind changing conditions in the general and agricultural economies and are strongly influenced by expectations of future trends and the availability of debt or equity financing.

Current cash corn prices have climbed to levels higher than previous price spikes. Strong demand for ethanol production has been a major factor contributing to higher crop prices, especially corn. Current price projections suggest crop prices will be at a higher level than realized in the past 10 years. This is a major factor believed to be leading to upward pressures on land values and cash rents.

After several years of relatively stable production costs, South Dakota farm production expenses for purchased inputs increased by at least 20–25% from 2003 to 2006, and significant increases are projected for 2008. Most of the increase is forecast

for fertilizer and energy-related costs. The 2008 survey will assist the Department of Economics in their analysis of whether higher production costs may be influencing land values and cash rent rates.

Farm real estate mortgage interest rates have dropped recently in response to fears of a recession. Rates annually averaged between 8% and 10% from 1991 to 2000 but declined to around 5.5% in 2002 and approached 6.75–8.0% in late 2006. Reduced mortgage interest rates should have positive impacts on farmland values, and 2008 survey respondents can indicate whether reduced mortgage interest rates are a factor in the 2008 agricultural land market.

Three-eighths of South Dakota agricultural land acres are in cash, share, or other lease arrangements (South Dakota Census of Agriculture 2002). The cash rental market provides important information on returns to agricultural land.

The 2008 survey will again ask respondents to report average cash rental rates per acre for non-irrigated cropland, irrigated land, and hayland in their localities. Cash rental rates for pasture/rangeland are requested on a per-acre basis and, if possible, on an Animal Unit Month (AUM) basis. Respondents will also be asked to report cash rental rates for high-

productivity and low-productivity land by different land uses in their locality.

The 2008 SDSU South Dakota Farm Real Estate Market Survey is a very important survey and the Department of Economics asks that everyone receiving a survey respond.

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Economics Department  
South Dakota State University  
Box 504 Scobey Hall  
Brookings, SD 57007-0895  
Phone: 605-688-4141  
Fax: 605-688-6386  
E-Mail: Penny\_Stover@sdstate.edu  
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SOUTH DAKOTA STATE UNIVERSITY  
Department of Economics  
Box 504  
Brookings SD 57007-0895

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