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method depreciation. The legislation also excludes from eligibility property described in I.R.C. § 50(b) (property used outside the United States, property used for lodging, property used by certain tax-exempt organizations and property used by governmental units or foreign persons or entities).

The new law also provides that expense method depreciation elections can be revoked (with respect to any taxable year beginning after 2002 and before 2006) by the taxpayer with respect to any property; the revocation, once made, is irrevocable.

Bonus depreciation amount

The Act increases the special allowance for eligible property acquired after September 10, 2001, and before September 11, 2004 (the cut-off date before the 2003 amendment) from 30 percent to 50 percent of the income tax basis of eligible property (after expense method depreciation has been claimed).

The increased allowance applies to property the original of which commences with the taxpayer after May 5, 2003 if the property was acquired by the taxpayer after May 5, 2003 and before January 1, 2005 if there was no binding contract for the acquisition of the property in effect before May 6, 2003. If there was a binding contract in effect before May 6, 2003, but not before September 11, 2001, the property remains qualified for the 30 percent allowance previously available.

The property must be placed in service under the new provision before January 1, 2005 except, for property described in I.R.C. § 168(k)(2)(B) (property having longer production periods) before January 1, 2006.

For passenger automobiles, which are subject to inflation-adjusted depreciation limits, the increase in the first year allowance for new vehicles under the bonus depreciation rules is boosted from \$4,600 to \$7,650 with the same effective dates as for the increase from 30 percent to 50 percent of the income tax basis of eligible property. Thus, for new passenger automobiles that are depreciable, the allowable depreciation is \$3,060 plus \$7,650 or \$10,710. For new passenger automobiles acquired before May 6, 2003, the limit is \$3,060 plus \$4,600 or \$7,660. The first year limit for used passenger automobiles remains at \$3,060.

Under the 2003 Act, an election with respect to any class of property for purposes of bonus depreciation does not apply to all property in the class.

The bonus depreciation amendments apply to taxable years ending after May 5, 2003.

Capital gains

The 2003 Act reduces the income tax rate on long-term capital gains from 10 percent to 5 percent for those in the 10 or 15 percent brackets and from 20 percent to 15 percent for those in higher income tax brackets. The reduction applies to both regular tax and alternative minimum tax calculations. For those in the 15 percent income tax bracket, the Act reduces the rate on long-term capital gains to zero for taxable years beginning after 2007 and before 2009 (unless changed in the meantime).

The provision applies to sales after May 5, 2003, in taxable years ending on or after May 6, 2003. The provision continues through 2007.

The provision provides for proration for 2003.

The 2003 Act wipes out the 8 and 18 percent rates from earlier legislation.

Dividends

Under the Act, dividends from domestic corporations (either C or S corporations) and qualified foreign corporations are generally taxed at the same rates as net long-term capital gain for taxable years beginning after December 31, 2002 and beginning before January 1, 2009. This provision applies for purposes of both regular tax and alternative minimum tax purposes. Thus, dividends will be taxed under the provision for 2003 at rates of 5 and 15 percent.

If a shareholder does not hold a share of stock for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date, dividends on the stock are not eligible for the reduced rates.

Corporate "penalty" taxes

The 2003 Act reduces the accumulated earnings tax rate (to 15 percent) and the personal holding

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company tax rate (also to 15 percent) effective in 2003.

Alternative minimum tax

The Act increases the AMT exemption amount for married taxpayers filing a joint return and surviving spouses from \$49,000 to \$58,000 and for unmarried taxpayers from \$35,750 to \$40,250 for taxable years beginning in 2003 and 2004.

Income tax rates

The Act accelerates the reductions in the regular income tax rates in excess of the 15 percent rate. For 2003 through 2005, the regular income tax rates in excess of 15 percent are 25 percent, 28 percent, 33 percent and 35 percent.

Beginning in 2005 and running through 2007, the Act increases the taxable income level for the 10 percent regular income tax rate brackets for single individuals from \$6,000 to \$7,000 and, for married individuals filing jointly from \$12,000 to \$14,000.

The Act increases the size of the 15 percent regular income tax bracket for joint returns to twice the bracket width of the 15 percent regular income tax rate bracket for single individuals for 2003 and 2004.

Standard deduction

The Act increases the basic standard deduction amount for joint returns to twice the basic standard deduction for single returns effective for 2003 and 2004. For taxable years beginning after 2004, the applicable percentages revert to those allowed under pre-Act law.

Child tax credit

The Act increases the child tax credit from \$600 to \$1,000 for 2003 and 2004. After 2004, the credit reverts to pre-Act levels.

For 2003, the increased amount of child credit is paid in advance, supposedly beginning in July, 2003, on the basis of information in each taxpayer's 2002 return filed in 2003. Advance payments are not expected to individuals who did not claim the child credit for 2002.

Corporate estimated tax

Under the Act, 25 percent of corporate estimated tax payments due on September 15, 2003, is not due until October 1, 2003.

Building New Competitive Advantages for the 21st Century

by Jason Henderson, Economist, and Nancy Novack, Associate Economist, Center for the Study of Rural America

A more detailed assessment of the challenges facing the rural economy and the need for new competitive advantages appears in the first quarter 2003 issue of the Federal Reserve Bank of Kansas City's Economic Review.

Rural America has struggled in the 21st century as a national recession and drought have battered rural and farm economies. Rural businesses, on and off Main Street, are facing stiff competition from a new set of foreign competitors. Many rural stakeholders are now searching for new ways to compete in tomorrow's economy. While the challenges remain daunting, some rural firms and communities are demonstrating that success in the 21st century can be built with a renewed commitment to entrepreneurship and technological innovation.

The erosion of rural competitiveness

Traditionally, the success of rural economies was founded principally on low-cost land and labor. Rural businesses often competed with their urban neighbors by being the low-cost producer. Rural firms developed competitive advantages surrounding the availability of these low-cost resources. And, many rural economic developers pursued development strategies that targeted land and labor-intensive industries to take advantage of these assets in their communities.

But globalization has brought new competitors to the rural landscape. Rural manufacturers now compete with foreign factories in addition to factories in U.S. cities. Foreign factories are able to compete effectively with rural manufacturers

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because they have even lower cost land and labor—a challenge also facing America’s farmers.

Signs of rural America’s eroding competitive advantage are emerging. Roughly a third of rural factory job losses in 2002 were caused by factory closings. Some of the losses in factory jobs can be attributed to the relocation of branch plants to foreign countries that have lower labor costs. Similarly, U.S. farmers face increased competition from South American producers in global markets. In 2002, South American soybean production outpaced U.S. production for the first time in history, continuing a severe contraction in U.S. market share over the past decade.

New competitive advantages for the 21st century

To compete in the 21st century, rural industries will need to be innovative in finding business solutions that go well beyond low-cost land and labor. Technical innovation and entrepreneurship will be the hallmarks of rural prosperity. Success will depend on management skills in addition to production capabilities. New products will need to be developed. New technologies will need to be adopted to increase production efficiencies and create a new competitive edge for rural industries.

To be sure, technical innovation and entrepreneurship have always been a part of rural America. In the past two centuries, for instance, the time required to produce 100 bushels of corn fell from 82 hours in 1850 to just 2 in 2000. Technical innovations have also driven huge efficiency gains that have boosted rural productivity. Productivity gains were a primary driver of U.S. economic growth in the 1990s. Innovative entrepreneurs are a key channel for capturing the benefits of these gains. Accordingly, the most entrepreneurial countries enjoyed the strongest levels of economic growth heading into the 21st century.

While the challenges to building new sources of competitive advantage are daunting, some rural areas are already finding new ways to prosper using technological innovation. One such example comes from England, Inc., a rural furniture manufacturer in New Tazewell, Tenn. England is

a custom-order furniture manufacturer that produces roughly 11,000 built-to-order sofas and chairs each week. To regain its competitive advantage over foreign competitors, England geared its success to reducing delivery time for its products. By using new technologies and smaller, more flexible production runs, England cut its delivery times to less than a month, a significant reduction from five years ago. Competitors have found it hard to match the shorter delivery schedule. The result has been prosperity for England and job benefits for a very rural community. In 2001, for instance, the U.S. furniture industry as a whole saw both sales and workforce fall by 9.3 percent while England enjoyed an 8.3 percent increase in sales and expanded its workforce by 7.4 percent.

New Tazewell has prospered by delivering existing products in new ways, but other rural communities are also benefiting from firms that create new products from advanced technology. For example, in November 2001, Cargill/Dow LLC opened a processing plant in Blair, Neb. that turns corn into packaging and other synthetic fibers. Using the latest technology, the facility produces polylactide polymers that are used in a variety of fabric products ranging from clothing, upholstery, to diapers. At capacity, the facility is expected to employ over 100 people and use 14 million bushels of corn.

Summary

In sum, technological innovations and entrepreneurial firms are helping some rural businesses find new ways to compete in a global economy. Today’s global environment means rural America must build new sources of competitive advantage, ones that go beyond low-cost land and labor for its communities. Rural farmers, businesses and communities will need innovative, entrepreneurial solutions to discover new engines of growth. New technologies will be needed to develop new rural products. New regional partnerships will be needed to build critical mass in the industries of the future. The rural economy appears to be at another turning point in its history, a point where the most innovative and entrepreneurial communities are in the best position to create new opportunities and prosperity in the 21st century.

Overcoming Information Barriers in Cattle Marketing

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Editor's Note: This article is adapted from a CARD briefing paper, "Quality Management and Information Transmission in Cattle Markets: A Case Study of the Chariton Valley Beef Alliance." The full text of the briefing paper is available at www.card.iastate.edu.

Beef consumption has declined steadily over the last two decades, both in total quantity and as a share of U.S. meat consumption. Reductions in the price of pork and poultry and health concerns about the effects of red meat consumption account for much of this trend. However, relative improvements in the quality and consistency of pork and poultry products may also be a factor. Perhaps it is no coincidence that the beef industry has trailed pork and poultry in adopting methods for vertical coordination among the various production stages from farm to market. Contract arrangements and vertical linkages—alliances among producers, processors and retailers—are common in pork and poultry production. Beef production, on the other hand, mainly is still coordinated through traditional market structures.

Whether vertical coordination of the kind observed in pork and poultry markets is necessary for further improvement in beef quality is a question that beef industry participants currently are trying to sort out. The beef industry has adopted a variety of novel marketing practices in recent years to improve quality and reduce overall production costs. At one extreme are recent attempts to fully integrate the beef production process, with a single firm coordinating genetic selection, feeding practices, slaughter and fabrication, and marketing. Long-term marketing arrangements between feedlots and packers represent a somewhat less extreme form of integration and have been used in some production areas for many years. Interestingly, the most widely adopted change in recent years—so-called grid pricing—represents an attempt to improve market coordination through more sophisticated quality-based pricing mechanisms. In this case, and in contrast with direct vertical integration, there are essentially no formal vertical linkages; instead, the process attempts to improve vertical coordination through the communication of precise signals about the relative value of various carcass attributes.

Behind all these efforts is at least one common objective: to align incentives so that quality improvement is in everyone's best interest. It seems that many of the traditional methods for marketing live cattle (both feeder and finished cattle) are not designed with this objective in mind. In particular, in traditional marketing, the flow of production-relevant information across

the various stages of beef production is significantly restricted.

Cattle Markets and Information Transmission

The production process for beef cattle is typically characterized in terms of a number of distinct stages starting with genetic selection and breeding, then rearing and weaning, and finally fattening to market weight (finishing) and slaughter. Specialization in cattle markets to some extent mirrors each of these stages: seedstock firms control genetic selection and breed development; ranchers manage cow and calf herds and raise young calves through the weaning stage; feeders raise animals from weaning to market weight; and packers slaughter and process live animals. Although there are many variations on this structure of specialization, for the moment we will focus on this particular arrangement.

We can characterize efficient decision making at each production stage, subject to a given set of growing conditions, breed types, feed costs, other market parameters and other pieces of production-relevant information. For instance, a feeder's nutrition and health maintenance program for a given animal (or lot of animals) might conceivably depend on nutrition and treatment histories during the rearing and weaning production stages, thus creating the need for information transmission from ranchers to feeders. It may also be important to transmit information in the reverse direction, from feeders to ranchers. For example, ranchers need information on feeders' management procedures, finishing performance and post-slaughter carcass quality in order to evaluate past decision making.

While sharing this kind of information may seem like an obvious requirement for efficient decision making in beef production, in fact it rarely occurs. Tracking, recording and transmitting information is costly. If the costs are high enough, the transacting parties may choose to either forgo information transmission entirely or may seek some substitute information that is not quite as detailed but is less costly to obtain. In the context of markets for feeder calves, many feedlots employ order buyers to visually inspect calves for traits that are appropriate to the particular operation. However, any such visual inspection, no matter how experienced the buyer, is an imperfect substitute for perfect transmission of all production-relevant information. Specifically, vaccination, nutrition and treatments histories cannot be observed. Feedlots assume a worst-case scenario, often expecting the need to readminister treatments,

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and they therefore reduce bid offers. Similar problems arise in the transmission of information from packers to feeders and ranchers.

The Chariton Valley Beef Alliance

The Chariton Valley Beef Alliance (CVBA) is a group of 350 southern Iowa cattle producers who are attempting to overcome these problems. The CVBA has been in place since early 1998. The alliance arose because area packers increasingly used grid-pricing arrangements and the producers wanted to learn to produce, sort and market cattle more effectively under these arrangements. Carcass data collection and source verification are two of the alliance's primary activities.

Carcass Data Collection

Grid marketing involves the pricing of individual animals (rather than lots of animals) based on the measurement of various carcass-quality attributes. Yet, animal-specific carcass measurements are rarely transmitted back to the feeders and cow-calf producers who deliver under these arrangements. Perhaps the most important activity of the CVBA is to facilitate and coordinate this transmission. Producers interested in obtaining carcass data pay a service fee to the CVBA (\$3-\$8 per head). The CVBA then coordinates with a third party to physically carry out carcass measurement during slaughter, recording them in electronic form for access by the relevant producer. Packers cooperate in this process by allowing third-party access to the slaughter floor for traits measurement (beyond those reported in USDA yield and quality grades). The CVBA additionally provides support for accessing and interpreting the relevant data. This analysis allows growers to make better marketing, nutrition and genetic decisions.

While it might seem a small matter to distribute animal-specific carcass-quality data to producers (given that prices are based on this data), in fact it is quite complicated and costly. As we noted, doing so adds \$3 to \$8 dollars per head to the cost of production. Iowa State University Extension estimates a gross margin of roughly \$15 per head for Iowa feedlots.

Source Verification

Assessing quality in markets for feeder cattle is a notoriously difficult task. USDA quality grades do exist for feeder cattle, but they are rarely used. Instead, most quality assessment is accomplished through visual inspection by experienced buyers. Of course, many of the important quality characteristics of feeder calves are not fully expressed until the calves have been fattened and readied for slaughter. One means of making this process more objective is to provide third-party verification of genetic and health characteristics of feeder cattle. In addition to providing an objective measure of quality, source verification provides feedlots with accurate information on the status of medical treatments that have occurred before the point of sale and on the genetic composition of animals in a given lot. In addition, the CVBA's source verification program includes agreements by those receiving information on feeder cattle to return information on carcass quality. Information thus flows in both directions.

An Evolving System

Vertical integration can be defined in many ways, and it is not clear what specific type of arrangement may be necessary to further improve coordination. Whatever the type, however, the feature that seems most important in cattle markets is the establishment of a long-term (and potentially exclusive) relationship among the transacting parties.

While clearly beneficial in some respects, long-term commitments (that is, vertical integration) also entail costs. In particular, the parties to such an agreement limit their use of markets, which offer greater flexibility in procurement and sourcing options, enhanced price discovery, and arguably higher-powered incentives for cost-reducing efforts. Firms inevitably involve elements of bureaucracy that can lead to higher overall production costs. Activities by organizations such as the CVBA therefore can be viewed as attempts to achieve the degree of coordination and information transmission observed in firms without sacrificing the benefits associated with market institutions. Time will tell whether such an outcome can be achieved.

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