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Turning Straw into Gold: Federal Securitization of Agricultural Commodities

by

Galen E. Boerema

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INTRODUCTION

The American agricultural industry has long enjoyed special status in the eyes of Congress. The twin rallying cries of safe food supply and satisfied constituents have proven to be an intoxicating siren's call to vote-starved politicians seeking to distribute favors via omnibus farm bills.[1] However, the crushing cost of commodity subsidies—over 165 billion dollars in the past eight years—brings into question the long-term viability of such programs.[2] The family farm is a different entity than it was at the inception of subsidy programs during the New Deal,[3] but Congress has not changed subsidies apace, resulting in misallocated and profligate spending.[4] The issue of how to restructure the subsidy programs becomes more urgent as a record

1. *See infra* Parts I.B–C (discussing the history of subsidy programs, including the Food Security Act of 1985, the Food, Agriculture, Conservation and Trade Act of 1990, and the Farm Security and Rural Investment Act of 2002).

2. *See, e.g.*, U.S. DEP'T OF AGRIC., REPORT OF THE COMMISSION ON THE APPLICATION OF PAYMENT LIMITATIONS FOR AGRICULTURE 8–12 (Aug. 2003) [hereinafter COMMISSION REPORT] (examining the effects of possible limitations of agriculture subsidies and concluding that increased regulation of the timing and nature of payments is essential to the long-term viability of such programs), http://www.usda.gov/oce/oce/payments/paymentLimitsAll.pdf (on file with the North Carolina Law Review). *Id.* app. A at 131–35 (listing farm subsidy amounts and types over the past eight years).

3. *See* U.S. DEP'T OF AGRIC., AGRICULTURE FACT BOOK 24–35 (2001–2002) [hereinafter AGRICULTURE FACT BOOK] (noting the growth in the size of farms, diversification in operations, and shrinking number of farmers from the turn of the century to present), http://www.usda.gov/factbook/2002factbook.pdf (on file with the North Carolina Law Review).

4. *See* COMMISSION REPORT, *supra* note 2, app. A at 131–35 (noting the amount spent on various farm subsidy programs since 1996); *see also* Brian M. Riedl, *The Cost of America's Subsidy Binge: An Average of $1 Million Per Farm*, BACKGROUNDER, Dec. 10, 2001, at 3 (stating that based on analysis of estimates by the Congressional Budget Office and subsequent actual expenditures on farm subsidies, "annual 'emergency payments' to farmers have increased the amount of government farm payments by 67 percent over projected expenditures" from 1990 to 2001), http://www.heritage.org/Research/Agriculture/BG1510.cfm (on file with the North Carolina Law Review).

budget deficit has Congress looking to cut spending, which may endanger even longstanding beneficiaries such as the agriculture industry.

However, without subsidies, American agriculture cannot compete in a global industry where subsidies, whether direct or indirect, are crucial to a nation's competitiveness in the international market.[5] For farmers, subsidies are not easily foregone, since subsidization of commodities and crop insurance enable American farmers to compete against nations with lower production costs and looser environmental regulations.[6] In a very real sense, American farmers feel that the contributions they make to American society in the form of affordable and safe food fully entitles them to whatever compensation they receive in the form of federal subsidies.[7]

The issue then becomes whether a mutually satisfactory balance can be struck between the interests of taxpayers and agricultural producers, a solution that simultaneously lowers costs to taxpayers and increases benefits for producers. Efforts have been made in the past to restructure federal involvement in the American agricultural system, but the efforts have largely been aimed at reallocation of scarce federal funds, which has done little to placate either party.[8] What is needed is a new approach, one that reflects the strengths of the American economy: political stability and a highly developed financial infrastructure.

Securitization refers to the use of financial instruments to pool

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5. *See Formulation of the 2002 Farm Bill: Hearings Before the Subcomm. on General Farm Commodities, and Risk Management, H.R. Comm. on Agriculture*, 107th Cong. 107-10, at 797–1013 (2001) (Sup. Doc. No. Y4.AG 8/1:107-10) [hereinafter 107th *Congress Hearings*] (noting the various justifications for increasing payments under the 2002 farm bill).

6. *Id.* Some of the United States' major competitors in the global agricultural market, such as China and Brazil, have lower environmental standards than the United States. The United States has argued that other competitors, such as the nations comprising the European Union, subsidize producers at rates equal to or in excess of American subsidies, thus lowering the effective cost of production for those nations. *See* Edward Alden & Deborah MacGregor, *A Cash Crop*, FIN. TIMES, May 10, 2002, at 18. Whether other nations subsidize agriculture directly or indirectly, without some form of federal assistance American farmers would be at a huge disadvantage in comparison to global competitors. *See infra* notes 19–21 and accompanying text.

7. *See* 107th *Congress Hearings*, *supra* note 5, at 857–58 (statement of Chuck Nichols) (stating "[o]ur family has been involved in California agriculture for the past forty-five years .... [o]ur company uses USDA Market Assistance Program funds .... [w]e cannot stop, and should not stop, the countries of the world from improving their ability to produce, process and market agricultural crops, but should not continue to have American farmers bear the entire cost").

8. *See infra* Part I.B (discussing subsidy program history).

illiquid assets, separate them from their originators, and offer them as securities on capital markets.[9] This Comment proposes that the efficiencies created by securitization would benefit investors and farmers, while simultaneously lowering the cost of the federal subsidy programs, through what has been described by one commentator as the "alchemy" of securitization.[10] By bundling commodities into securities, which can be offered on the capital markets, the government can tap the dollars of investors without forcing all taxpayers, investors or not, to bear the entire burden of subsidization.[11] The proceeds of the securitization would be delivered to farmers in sufficient amount and time to enable them to produce the crops that the nation depends on for its food supply.[12] Investors would be offered a diversified investment with a guaranteed return.[13] This Comment argues that federal securitization is preferable to direct subsidies because it offers cheap capital to all farmers rather than disproportionately favoring those who are already profitable. In this way, the federal government can more directly benefit struggling, smaller farms without penalizing more profitable farms, as it currently does by capping direct subsidies. By sponsoring commodity-backed securities on the capital markets, Congress can begin to close the gap between the rhetoric and the reality concerning American agriculture.

Part I of this Comment gives an overview of the policy and history of American crop subsidies and outlines the provisions of the Farm Security and Rural Investment Act of 2002, which contains the current commodity subsidization legislation.[14] Part II introduces the general concepts of securitization and provides an overview of the issues unique to agricultural commodity securitizations. Part III offers a model for the federal securitization of commodities to replace the current direct subsidy system. By utilizing this model to take advantage of the United States capital markets, Congress can procure the funds needed to advance the goal of developing the "most efficient and reliable means to produce our food."[15]

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9. Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 134 (1994).

10. *Id.*

11. *See infra* Part II.A.

12. *See infra* Part III.A.2.

13. *See infra* Part III.A.4.

14. Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134–42, 509–10 (2002) (codified at 7 U.S.C.A. §§ 7901–19, 7931–36 (West Supp. 2004)).

15. *See* H.R. COMM. ON AGRIC., 106th CONG., REVIEW OF FEDERAL FARM POLICY 6 (Comm. Print 2000) (Sup. Doc. No. Y4. AG 8/1:106-50/pt.1) (statement of Rep. Bill

I. THE FEDERAL SUBSIDIZATION FRAMEWORK

A. *Policy Reasons for Subsidizing Agriculture*

Completely eliminating agricultural subsidies would be the least costly alternative for the federal government (and hence taxpayers) in the short-term.[16] However, as outlined below, there are several reasons why agriculture is subsidized in the United States, and it is important to understand the policy reasons underlying subsidization before methods to improve it can be identified.

By taxing all consumers and redistributing money to commodity producers, the cost of commodities to everyone may be reduced. While this may disproportionately favor taxpayers who use more commodities, it also results in affordable, safe food for the entire population, meeting consumer expectations.

While the reasons for keeping the general populace fed and clothed in a relatively affordable and safe manner are fairly obvious—imagine the outrage if food and clothing prices suddenly doubled or tripled—there are also national security reasons advanced for encouraging domestic production.[17] Increasing dependency on imported fossil fuels underscores the necessity of avoiding a similar situation regarding other commodities, since dependence on imported basic commodities puts the United States at the mercy of another nation's whims and political prerogatives.[18] The necessity of keeping citizens fed makes a self-sustaining agricultural industry particularly

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Barret) ("[W]e must continue to develop the most efficient and reliable means to produce our food"), *available at* http://commdocs.house.gov/committees/ag/hagfarm13.000/hagfarm13_0f.htm (on file with the North Carolina Law Review).

16. The position that subsidies should be eliminated altogether is not without adherents. *See* David E. Adelman & John H. Barton, *Environmental Regulation for Agriculture: Towards a Framework to Promote Sustainable Intensive Agriculture*, 21 STAN. ENVTL. L.J. 3, 13 (2002) (stating that current subsidy policies provide "incentives and . . . bias against alternative agricultural methods under U.S. policies"); J. Bishop Grewell, *Farm Subsidies are Harm Subsidies*, AM. ENTERPRISE, Oct.–Nov. 2003, at 49 (stating that "[f]arm subsidies . . . [are] perverse: not good for the environment, not good for farmers, and not good for consumers"); *Hurtful Farm Subsidies*, L.A. TIMES, Aug. 25, 2003, at B10 (noting the dampening effect subsidies in developed countries have on global trade).

17. Daniel A. Sumner, FOOD SECURITY, TRADE AND AGRICULTURAL POLICY 1 (Sept. 10, 2000) (noting that "[n]ational agricultural policies are often rationalized on 'food security' grounds," meaning that a nation's overall security is directly related to how reliably it can feed its citizens), http://www.aic.ucdavis.edu/research/fs9.10.00.pdf (on file with the North Carolina Law Review).

18. In the United States in 2004, imports of oil totaled about sixty-one percent of consumption; forty percent of 2002 oil imports came from OPEC member nations. *See* Gibson Consulting, *Some Interesting Oil Industry Statistics*, *at* http://www.gravmag.com/oil.html (last visited Jan. 19, 2005) (on file with the North Carolina Law Review).

important; it is one thing if China decides to stop shipping plastic toys to the United States and quite another if Brazil decides to stop shipping soybeans. Similarly, while industrial production may not be as vital an interest as feeding the populace, domestic manufacturers also depend on cheap, reliable sources of commodities.

Other nations also subsidize commodity producers, and the United States argues that it must do the same to maintain global parity.[19] If Brazil can produce soybeans for $2.00 a bushel because its government adopts a policy of giving producers free land and relaxing pesticide and herbicide regulations, then Brazilian producers could flood the American market with soybeans at a price below that at which American producers can break even. Likewise, if the Japanese government subsidizes its rice producers with a payment equal to $1.50 a kilogram, then Japanese producers can effectively sell their rice for $1.50 less than competitors who do not receive such a subsidy.[20] Achieving global parity in the area of agriculture has become a major issue in global trade talks, as poorer nations argue that they are frozen out of international markets by the subsidy policies of wealthier nations.[21]

To ensure domestic stability and to compete globally, some form of subsidization of commodity production has become a practical and political necessity. Despite increasingly vociferous cries to end or limit subsidies,[22] reality dictates that it is a foregone conclusion that at

19. *See Farmer's Market*, WALL. ST. J., Aug. 3, 2004, at A10 (noting that the three entities that subsidize agriculture most heavily—the United States, the European Union, and Japan—all argue they must do so to remain competitive with each other, to the detriment of developing nations that cannot afford subsidies and thus cannot compete); *see also* 107th *Congress Hearings*, *supra* note 5, at 1299 (statement of Rep. Everett) (stating that farmers find it difficult to compete against countries where labor is cheaper and compliance with environmental regulation less onerous).

20. *Farmer's Market*, *supra* note 19 (noting that competitors in the Japanese market must "climb a 490% tariff wall" in order to sell their products).

21. *See id.* (noting that a proposed drop in the agricultural subsidy programs of the European Union, Japan, and the United States "[a]t long last [allows] poor countries . . . to participate more fully in the world trading system"). The lobbying efforts of special interest groups have often been cited as a reason for agricultural subsidies, as well. *See, e.g.*, John C. Roberts III & Erwin Chemerinsky, *Entrenchment of Ordinary Legislation: A Reply to Professors Posner and Vermeule*, 91 CAL. L. REV. 1773, 1809–11 (2003) (noting that, in general, groups that are more organized and intentional in efforts to gain governmental concessions receive a disproportionate level of benefit in relation to their relative size); *The Unlikeliest Scourge*, ECONOMIST, July 13, 2002, at 22–24 (noting the effect that certain lobby groups—in particular, sugar—had on shaping the current Farm Bill).

22. *See* Franz Fischler, *Why Can't America Be More Like Us?*, WALL ST. J., Feb. 19, 2004, at A12 (arguing that the European Union has made a "whopping 70% reduction in trade-distorting farm support," and urging the United States to do the same).

least some federal subsidies will be provided for the foreseeable future, and the issue then becomes finding the most effective and efficient way to provide them.

B. Background of Commodity Subsidization in the United States

In the twentieth century, the face of agriculture changed dramatically. Consolidation has resulted in larger farms and fewer farmers.[23] Although ninety-eight percent of farms are identified by the United States Department of Agriculture ("USDA") as "family farms," many are organized as corporations.[24] In 1940, there were six million farms averaging 150 acres each.[25] By the late 1990s, there were only about 2.2 million farms averaging 447 acres in size.[26] During roughly this same period, farm employment declined dramatically—from 12.5 million in 1930 to 1.2 million in the 1990s—even as the total population of the United States more than doubled.[27] By 2000, sixty percent of farmers worked only part-time on farms; they held other, non-farm jobs to supplement their farm income.[28]

The current subsidy system must be considered in the context of the shrinking number and increasing size of American farms because the original subsidy program was constituted on the assumption of many small farms and operators.[29] Proponents of agricultural subsidy programs continue to employ the rhetoric of the "family farm" in justifying payments to the agricultural industry.[30] However, the

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23. The number of farms comprising 500 acres or more increased from four percent in 1935 to eighteen percent in 1997. *See* AGRICULTURE FACT BOOK, *supra* note 3, at 25. The number of total farms in the United States has steadily declined since 1935, from a high of nearly seven million, to just under two million in 1997. *Id.* at 24.

24. *Id.* at 29. Corporate ownership has also changed who actually owns the land that is being farmed. In 1997, sixty percent of farmers identified themselves as full owners of their farms. *See* NAT'L AGRIC. STATISTICAL SERV., U.S. DEP'T OF AGRIC., 1997 CENSUS OF AGRICULTURE, http://www.nass.usda.gov/census/census97/highlights/usasum/us_fig1.gif (on file with the North Carolina Law Review). The remainder farmed rented land or partially owned the land they farmed. *Id.*

25. *See* CHRISTOPHER CONTE & ALBERT R. KARR, *American Agriculture: It's Changing Significance*, *in* AN OUTLINE OF THE U.S. ECONOMY (Feb. 2001), http://usinfo.state.gov/products/pubs/oecon/chap8.htm (on file with the North Carolina Law Review).

26. *Id.*

27. *Id.*

28. *Id.*

29. *See id.* (noting the number of farms and the relatively small size of subsidy distributions in the 1940s).

30. *See generally* 107th *Congress Hearings*, *supra* note 5 (gathering the statements of over 175 farmers for the purpose of assessing the need for federal assistance to American farms).

family farmer of today is as likely to own a large, incorporated operation with several employees as he is to resemble the dour patriarch depicted in *American Gothic*.[31]

Federal subsidization of American agriculture was first embraced as a formal policy with the creation of the federal Farm Board by President Herbert Hoover in 1929.[32] The primary purpose of the Farm Board was to gather and to distribute information regarding sound farming practices, but the Great Depression soon brought into sharp relief the need for greater economic assistance for farmers.[33] In response to the burgeoning economic crisis, President Franklin D. Roosevelt proposed, and Congress approved, a sweeping system of price supports and quotas limiting farm production.[34] This system came to be known as the "parity system" because of its central theory that prices should be pegged to a target price predicated on a favorable market year.[35] Should prices fall below the target, the federal government would sponsor a subsidy to make up the difference.[36]

By the 1950s, rapidly developing agricultural production techniques had made farmers their own worst enemies; because of much higher average yields, overproduction was glutting the market and making the parity subsidy system more expensive.[37] Rising agricultural production made the price support system, at least in its New Deal incarnation, prohibitively expensive by the early 1970s.[38] Congress could not afford subsidies at the old levels, but did not retreat from its policy of subsidizing agriculture.[39] In 1973, the first form of modern "deficiency payments" was enacted.[40] Deficiency

31. Although ninety-two percent of farms are still classified as "small" (meaning gross revenues of less than $250,000) by the USDA, the remaining eight percent, which includes large family farms and family owned corporations, account for sixty-eight percent of production. AGRICULTURE FACT BOOK, *supra* note 3, at 24–29. *American Gothic* is a painting by Grant Wood depicting what is ostensibly the typical sober Midwestern farmer around the turn of the century. The painting can be viewed online at http://www.skfriends.com/american-gothic.htm (last visited Jan. 31, 2005) (on file with the North Carolina Law Review).

32. *See* CONTE & KARR, *supra* note 25.

33. *See id.*

34. *See id.*

35. *See id.*

36. *See id.* ("In years of overproduction, when crop prices fell below the parity level, the government agreed to buy the excess.").

37. *See id.*

38. *See id.* (noting that the cost of government price supports rose dramatically through the 1950s, 1960s, and 1970s).

39. *See id.*

40. *See id.*

payments were similar to the parity system in that a target market price was set and if the market price fell below the target price, the federal government would make up the difference.[41] However, as a condition on the receipt of government funds, farmers were required to remove land from production.[42] By the early 1980s, almost twenty-five percent of American cropland had been idled.[43]

Idle cropland and lower support prices did not mean a cheaper farm program. Payments to agricultural producers exceeded $20 billion annually by the 1980s.[44] Nor did subsidy payments prevent thousands of agricultural bankruptcies in the 1980s, as farmers paid the price for borrowing at inflationary interest rates to expand production.[45] Taxpayers were also disgruntled with programs that paid farmers a "ransom" not to produce commodities.[46] Amid calls for smaller government, Congress responded by passing the Food Security Act of 1985,[47] which reduced support prices and allowed for the idling of more land.[48] Although the 1985 Act did not represent a major policy shift, improvements in the economy contributed to lower overall subsidy payouts.[49] By the late 1980s, though, ballooning payments forced Congress to reconsider its strategy once again.[50] Congress responded with the Food, Agriculture, Conservation, and Trade Act of 1990,[51] which reduced the amount of deficiency payments and encouraged growing new crops traditionally outside the subsidization structure.[52] Price supports for existing crops were virtually unchanged, however.[53] Predictably, payments again rose.[54]

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41. *See id.*

42. *See id.*

43. *See id.*

44. *See id.*

45. *See* ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., BANKRUPTCIES: AN HISTORICAL PERSPECTIVE OF FARMER BANKRUPTCY (Aug. 9, 2004), http://www.ers.usda.gov/briefing/bankruptcies/BankruptciesHistory.htm (on file with the North Carolina Law Review).

46. *See id.*

47. Food Security Act of 1985, Pub. L. No. 99-198, 99 Stat. 1354 (codified at 7 U.S.C.A. § 1421 (West Supp. 2004)).

48. *Id.*

49. *See* CONTE & KARR, *supra* note 25. The lower cost of production inputs, such as fuel, fertilizer costs, and improving commodity prices combined to make farms more profitable independent of subsidies. *See id.*

50. *See id.*

51. Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. No. 101-624, 104 Stat. 3359 (1990) (codified as amended in scattered sections of 7 U.S.C.A. (West Supp. 2004)).

52. *See* CONTE & KARR, *supra* note 25.

53. *See id.* (stating that "[t]he new law retained high and rigid price supports for certain commodities").

The mid-1990s saw the election of a Republican Congress determined to cut costs, and the Federal Agriculture Improvement and Reform ("FAIR") Act of 1996[55] represented a drastic departure from previous federal agricultural policy.[56] Gone were the restrictions on planting; gone also were the most lucrative production and price support payments.[57] These payments were replaced with new, lower, fixed payments that were not pegged to target prices.[58] Instead, payments were made based on ownership of productive cropland and a small "marketing assistance" subsidy of commodities.[59] To smooth the transition from a system that many producers had been familiar with their entire lives, Congress earmarked $36 billion in fixed payments over seven years.[60] The crashing commodity market of the late 1990s soon exhausted those payments,[61] and Congress was forced to pass a series of emergency bills that re-implemented the target price methodology of previous bills.[62] By 2000, farm subsidy payments exceeded $29.8 billion for a

54. *See id.*

55. Federal Agriculture Improvement and Reform Act of 1996, Pub. L. No. 104-127, 110 Stat. 888 (commodity subsidy changes codified at 7 U.S.C.A. § 1421 (West Supp. 2004)).

56. *See* 110 Stat. at 896–904. For an analysis of the passage of legislation that represents a change in the political landscape see Roberts & Chemerinsky, *supra* note 21, at 1810 (stating that "[t]he Federal Agriculture Improvement and Reform Act of 1996, a centerpiece of the free market reform agenda championed by the Republican-controlled House, reversed decades of national policy by eliminating most agricultural subsidies").

57. *See* 7 U.S.C.A. § 1421(a)–(e) (West Supp. 2004) (outlining the new system based on fixed payments).

58. *See* CONTE & KARR, *supra* note 25.

59. *See* 7 U.S.C.A. § 1421(a), (d).

60. *See* CONTE & KARR, *supra* note 25. The fixed payments were not contingent on production and were sometimes paid out on the basis of being in the business of farming or, in some cases, merely for owning eligible land. *See* Philip Brasher, *Farm co-ops, giant farms benefit from bypassing limits*, BISMARCK TRIB. (N.D.), Oct. 1, 2001, at 2A (noting that landholding companies and other entities collected farm subsidies simply by dint of owning land).

61. *See* LARRY COMBEST, RESPONDING TO THE CONTINUING ECONOMIC CRISIS ADVERSELY AFFECTING AMERICAN AGRICULTURAL PRODUCTS, H.R. REP. NO. 107-111, at 5 (2001), *reprinted in* 2001 U.S.C.C.A.N. 318, 319. Combest explained:

> In 2000, crop prices were at a 27-year low for soybeans, a 25-year low for cotton, a 14-year low for wheat and corn and an 8-year low for rice .... The current farm recession, in its fourth year, ranks among the deepest in our nation's history, along with the Great Depression, the post-World War I and II recessions, and the financial ruin of the 1980s.

Id.

62. *See* Sarah Feinberg, Press Release, Environmental Working Group, Congress To Approve Emergency Farm Aid for Fourth Year—$5.5 Billion Added to Subsidies (June 26, 2000) (noting that in 2000, for the fourth straight year, Congress had been forced to

single year, a new record.[63] The clamor for restructuring led Congress to overhaul the subsidy system again in 2002.[64]

C. Current Agricultural Subsidization: FSRIA

1. Introduction

The overhaul of the subsidy system was accomplished by the new commodity programs established by the Farm Security and Rural Investment Act ("FSRIA"), which were implemented in 2002.[65] The scope of this Comment does not allow full examination of FSRIA, an enormous and enormously complex statute.[66] The analysis will be limited to direct federal subsidies of American agricultural commodities, the area where the switch to securitization offers the most possibilities for improvement.[67] The FSRIA also subsidizes crop insurance against weather loss and continues an extensive program designed to reduce the amount of land in production.[68] These programs are statutorily separate from the subsidization program, but

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supplement the 1996 FAIR Act that was intended to end farm supports), http://www.ewg.org/reports/farmfairness/ (on file with the North Carolina Law Review).

63. U.S. DEP'T OF AGRIC., FY 2002 BUDGET SUMMARY, http://www.usda.gov/agency/obpa/Budget-Summary/2002/master2002.pdf (on file with the North Carolina Law Review); *see also* Brian M. Riedl, *Agriculture Lobby Wins Big in New Farm Bill*, BACKGROUNDER, at 2 (Apr. 9, 2002), http://www.heritage.org/Research/Agriculture/BG1534.cfm (on file with the North Carolina Law Review).

64. For a sample of how the 1996 FAIR Act was viewed among farmers, see 107th *Congress Hearings*, *supra* note 5, at 809–10, 813 (statement of Andrew Quinn, corn and soybean farmer from Minnesota) (criticizing the payment system under the FAIR Act as unfairly favoring certain commodities—such as soybeans—and criticizing the difficulty of re-incorporating farmland enrolled in set-aside programs).

65. Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134 (commodity subsidy programs codified at 7 U.S.C. §§ 7901–19, 7931–36 (West Supp. 2004)).

66. Titles under the FSRIA include: Commodity Programs (Title I); Conservation (Title II); Trade (Title III); Nutrition Programs (Title IV); Credit (Title V); Rural Development (Title VI); Research and Related Matters (Title VII); and Crop Insurance (Title X). This Comment is concerned primarily with the commodity subsidization provisions of Title I codified at 7 U.S.C. §§ 7901–19, 7931–36.

67. Subsidized commodities include: wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds. *See* 7 U.S.C.A. § 7901(4) (listing "covered commodities" under the FSRIA).

68. The Food Security Act of 1985 authorized the Conservation Reserve Program ("CRP"), which is still in effect and governed by the provisions of 7 C.F.R. § 1410 (2004). *See* FARM SERV. AGENCY, U.S. DEP'T OF AGRIC., FACT SHEET: CONSERVATION RESERVE PROGRAM, (Feb. 1997), http://www.fsa.usda.gov/pas/publications/facts/crp1.pdf (last visited Mar. 2, 2004) (on file with the North Carolina Law Review). The CRP essentially pays agriculture producers to plant "long-term, resource conserving covers" on ecologically fragile land, effectively removing it from commodity production. *Id.*

often influence cropping decisions.

The subsidy paid per crop is the result of many factors, such as the nature of the crop, historic subsidy levels for the crop, and policy decisions by Congress.[69] Subsidies are roughly weighted to reflect the differing yields of each commodity and are based on a "target" price for each commodity.[70] Additionally, the government makes a fixed payment to landowners every year based on the historic yield of agricultural land in production.[71] To receive subsidies, a producer must meet the requirements of the FSRIA including, inter alia, that he is an owner, landlord, tenant, or sharecropper on a farm that has produced the eligible commodities.[72] Compliance with conservation measures is also required.[73] Commodity subsidization under FSRIA provides for four different types of payments. The Direct Payment ("DP") is a fixed payment based on historic yield on acres in production.[74] The Counter-Cyclical Payment ("CCP") is a variable payment that is employed when market prices fall below a target price.[75] The Marketing Assistance Loan ("MAL") is a Farm Service Agency ("FSA") loan to producers based on the amount of commodity a farmer has harvested and stored.[76] The Loan Deficiency Payment ("LDP") is a variable payment based on actual harvested

69. *See* 107th *Congress Hearings*, *supra* note 5, at 13–14 (statement of Rep. Saxby Chambliss) (noting that historic subsidy levels and the nature of the crop being subsidized should be taken into account when determining target prices). More cynical parties note the effects of political pressure brought to bear by special interest groups, and the effect this can have on congressional allocations of funds. *See supra* note 21 and accompanying text.

70. If market prices fall below the target price, the federal government will make up the difference. Commodity subsidy target prices vary from county to county. Specified loan rates for every county in the United States can be viewed at http://www.fsa.usda.gov/dafp/psd/loanrate.htm (last visited Jan. 31, 2005) (on file with the North Carolina Law Review). County levels are pegged to a federal target price, which can be found at 7 U.S.C.A. § 7914.

71. *See* 7 U.S.C.A. § 7913(a) (stating that payments will be made to producers for whom payment yields and base acres have been calculated). 7 U.S.C.A. § 7915 contains requirements intended to ensure that these payments end up in the hands of producers, but Congress has had little success in preventing non-farmers from receiving subsidies intended for farms. *See* Brasher, *supra* note 60 (noting that payment limits are routinely bypassed by large agricultural entities).

72. 7 U.S.C.A. § 7915. For a more in-depth review of the eligibility requirements of the FSRIA see generally Christopher R. Kelley, *Introduction to Federal Farm Program Payment Legislation and Payment Eligibility Law*, 2002 ARK. L. NOTES 11, 11–37 (2002).

73. 7 U.S.C.A. § 7915(a).

74. *See infra* Part I.C.2.

75. *See infra* Part I.C.3.

76. *See infra* Part I.C.4; *see also infra* note 79 (discussing the responsibilities of the FSA).

acres and actual harvested bushels.[77]

The following discussion outlines the relevant provisions of the current commodity subsidy program and examines their effects on farmers.

2. Direct Payments

a. Purpose and Methodology

Direct payments are based on calculations made employing the "program yield." Program yield is the amount of crop (usually measured in bushels) eligible for subsidy and is based on the historic production of a farm.[78] Program yield can be calculated using one of three methods, which the farmer may choose at his or her discretion.[79]

The first method of calculating program yield is to multiply the average yield for the previous three years by ninety-three and one half percent.[80] This method favors producers who have higher yields in recent production years. Because commodity production has trended upward over the past four decades,[81] many producers will choose this option.

The second method allows the producer to keep the "old" yields, that is, those calculated under the FAIR Act, which used similar algorithms to those used in the FSRIA.[82] This option would likely be favored by producers whose yield is static or dropping.

The third method is to use the old yields (those established for the FAIR Act) plus seventy percent of the difference between old yields and the average from the last three years.[83] This is a compromise position for those producers whose yield has risen, but

77. *See id.* LDP is derived from MAL and is not actually a separate subsidy but rather a different form of payment. *Id.*

78. 7 U.S.C.A. § 7912(b).

79. *Id.* § 7912(e)(3). Although the method of calculation is subject to the producer's discretion, the Farm Service Agency is currently responsible for administering the agricultural subsidy programs. *See* FARM SERV. AGENCY, U.S. DEP'T OF AGRIC., About Us: Mission and Goals, *at* http://www.fsa.usda.gov/pas/about_fsa/mission.htm (last visited Jan. 8, 2005) (on file with the North Carolina Law Review). The FSA determines payment eligibility and distributes payments via localized boards. County by county contact information is available at http://oip.usda.gov/scripts/ndisapi.dll/oip_agency/index?state=us&agency=fsa (last visited Jan. 11, 2005) (on file with the North Carolina Law Review).

80. 7 U.S.C.A. § 7912(e)(3)(B).

81. AGRICULTURE FACT BOOK, *supra* note 3, at 24 (noting the general upward trend in average agricultural yields in the United States).

82. 7 U.S.C.A. § 7912(b).

83. *Id.* § 7912(e)(3)A.

not enough to meet the efficiency threshold of the first option.

Once program yield is calculated, it can only be applied to base acres. Base acres are those registered in the federal programs.[84]

The Direct Payment is calculated by multiplying the payment rate per bushel by program yield, then multiplying by eighty-five percent of base acres.[85] For example, a farmer who owns 1000 acres with a program yield of 100 bushels of corn will be eligible for a DP on 85,000 bushels. The DP rate for corn under the FSRIA is $0.28 per bushel.[86] Thus, the farmer is eligible for a DP of $23,800 per year.

A producer may receive no more than $40,000 in DP every year.[87] The DP is a fixed payment in the sense that it is paid regardless of the current year's production. DPs are made after October 1 in the year of harvest.[88]

b. Effects on Producers

Because the DP is paid soon enough to offset the costs of the new growing season, it comes the closest to providing cheap capital to producers in a timely fashion to pay for planting and operating costs. However, the payment caps preclude many producers from fully taking advantage of the program and forces them to borrow elsewhere to meet capital needs. To close the gap, farmers may take out loans sufficient to meet their needs for the growing season with a private financial intermediary and repay out of the proceeds of the subsidies, which are received after harvest. This is an unnecessary duplication of transactions and may result in extra costs to the producer.

3. Counter-Cyclical Payments

a. Purpose and Methodology

The Counter-Cyclical Payment is the amount a producer is paid when national average prices are below the target levels specified in

84. *See id.* § 7901(a)(2) (defining base acres as "the number of acres established ... with respect to the covered commodity on the election made by the owner of the farm").

85. *Id.* § 7901(f). The payment rate per bushel is pre-determined and varies by differing commodity. *See id.* § 7913(b).

86. *Id.* § 7913(b)(2).

87. *See id.* § 1308(3)(b)(1) (stating that"[t]he total amount of direct payments made to a person during any crop year ... 1 or more covered commodities may not exceed $40,000.").

88. *Id.* § 7913(d)(1)(B).

FSRIA by more than the amount of the DP rate.[89] The CCP is intended to address only major shortfalls in the market price. As the market price rises near the target price, the CCP is lessened. If market prices are significantly below the target price, there is increasing liability on the part of the government.

The payment rate is calculated by subtracting the national season average market price from the target price.[90] The DP is then subtracted from the result.[91] For example, if the national season average market price is $2.30 per bushel, this is $0.30 less than the target price for corn, $2.60.[92] Thus, the producer of 100,000 bushels of corn is eligible for a gross CCP of $30,000. Any DP is subtracted from the gross CCP, so if we continue the prior example and the producer had already received $23,800 in DP, then he would be eligible for a net CCP of $6,200.

Payment levels per producer, per year, are capped at $65,000.[93] CCPs are paid at a ratio of thirty-five percent in October of the harvest year, thirty-five percent in February, and the remainder after the end of the twelve month marketing period for the covered commodity.[94] The CCP is paid regardless of the price actually received by the producer, since it is predicated on a national average price. It is variable with the amount of bushels produced.[95]

b. Effects on Producers

The CCP does little to truly protect producers against market swings, because the payment is not distributed until up to a year after the crop is sold.[96] A low market price for commodities can reduce income, making it difficult for producers to repay loans taken out for the growing season. Private loans must be extended until sufficient subsidy payments have been made to repay the loans, increasing interest and transaction costs. This can damage credit ratings and

89. *Id.* § 7914(a)–(b).

90. *Id.* § 7914(d)(1)–(2).

91. *Id.* § 7914(b).

92. *See id.* § 7914(c)(1) (establishing 2002 and 2003 target prices for eligible commodities including wheat, corn, grain sorghum, barley, and oats).

93. *See id.* § 1308(c)(1) (stating that "the total amount of counter-cyclical payments made to a person during any crop year . . . for 1 or more covered commodities may not exceed $65,000").

94. *Id.* § 7914(f)(3)(A)(i)–(iii).

95. *See id.* § 7914(d)(1)–(2) (noting that the payment rate is the difference between market price and target price for the "covered commodity").

96. *See supra* notes 93–95 and accompanying text (outlining the CCP payment schedule).

make it difficult to procure credit on favorable terms for the next growing season. As expensive capital makes the farm less profitable, this further damages credit, and the cycle continues until the farmer can no longer profitably farm. The CCP can prolong the viability of a farm by mitigating the effect of low commodity prices, but the timing of the payments forces the farmer to carry interest costs until payment is made, lessening the help such payments provide.

Additionally, because the CCP is tied to market prices, it provides a free hedge for producers who have the resources to take advantage of it. A hedge is essentially a bet that the market will move in the opposite direction from a previous position.[97] For example, a producer may forward contract all of his soybeans for delivery in November at a price of $6.00. If the price subsequently goes up, the farmer loses all the potential benefit of the price increase, because he has already sold his soybeans. To offset this risk, the farmer may purchase an option to buy soybeans at $6.00 in November (a "call"[98]) at the same time that he sells his soybeans. Any rise in price will make his call more valuable, since it represents the right to purchase soybeans at a price more favorable than market prices. The CCP acts as a down hedge; any price drop below a certain level will be reimbursed to farmers by the federal government (subject to the cap). Thus, a producer can "bet" that the market price will go down by selling short, and if the market price goes down, benefit from the position taken with options, while at the same time not be greatly hurt by falling market prices because of the federal subsidy. However, this system favors more profitable farmers who have the resources to afford the price of the options, as well as the time and sophistication to develop market positions. Like the other subsidies, the utility of the CCP is increased for profitable producers, to the detriment of less profitable producers.

97. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc., v. Curran, 456 U.S. 353, 358 (1982) (explaining that farmers and other market participants often take speculative positions to protect against price declines or increases, depending on their exposure to the market).

98. *See, e.g.*, Chi. Mercantile Exch. v. SEC, 883 F.2d 537, 543 (7th Cir. 1989) (stating that a call option is "a promise by the writer to deliver the underlying instrument at a price fixed in advance (the 'strike price') if the option is exercised within a set time"). Like hedging, a call option is a risk management tool that allows market risk to be spread over a number of parties. *Id.* A commodity option is an option to buy or sell a commodity. BLACK'S LAW DICTIONARY 1127 (8th ed. 2004).

4. Marketing Assistance Loans and Loan Deficiency Payments

a. Purpose and Methodology

Marketing Assistance Loans are loans made to producers by the Farm Service Agency based on the amount of the commodity that a farmer actually holds.[99] These loans are intended to give farmers the capital necessary to store their commodity and continue operations while waiting for favorable market conditions in which to sell their commodity.[100] The amount the FSA will loan a farmer is calculated using the "loan rate," which is the statutory price set for a given commodity.[101] For example, if a farmer has 30,000 bushels of corn in the bin after harvest, the FSA will loan him the value of the commodity as determined by the statutory loan price. If the price of corn rises, the farmer may sell the corn, repay the FSA, and keep the difference.[102] If the price of corn drops below the loan rate, the farmer has the option of simply turning over the commodity that was pledged as collateral, regardless of the prevailing market price at the time the loan is due;[103] because the loan is non-recourse, the farmer is not required to repay at the rate at which he borrowed.[104]

A producer may opt not to take out a loan on the stored commodities and instead be eligible to receive the difference between the market price on the day he sells and the loan price, if the market price is below the loan price.[105] Such a payment is known as a Loan

99. *See* 7 U.S.C.A. § 7931(a)–(b) (West Supp. 2004) (noting the availability of loan deficiency payment and marketing assistance loans); *see also* FARM SERV. AGENCY, U.S. DEP'T OF AGRIC., FACT SHEET: NONRECOURSE MARKETING ASSISTANCE LOAN AND LOAN DEFICIENCY PAYMENT PROGRAM 1 (June 2003) [hereinafter MAL & LDP FACT SHEET] (noting that loans can only be given for an eligible commodity that is pledged as collateral) (on file with the North Carolina Law Review).

100. *See* MAL & LDP FACT SHEET, *supra* note 99, at 1.

101. *See id.* (noting that the marketing assistance loan is only available for commodities pledged as collateral); *see also* 7 U.S.C.A. § 7932 (listing loan prices for eligible commodities).

102. *See* 7 U.S.C.A. § 7934(b)(1)–(2) (stating that producers shall be permitted to repay at the lesser of the "loan rate . . . established under § 7932 . . . plus interest" or the "prevailing world market price . . . as determined by the Secretary").

103. *See id.* In actuality, the farmer would probably sell the commodity, repay the FSA whatever the proceeds were, and keep the difference, rather than physically turn over the commodity.

104. *See* 7 U.S.C.A. § 7931(a) (noting the availability of "non-recourse" loans to eligible producers through 2007). However, in lieu of repayment of the loaned funds, the farmer must deliver the crop he borrowed on as collateral. *See* MAL & LDP FACT SHEET, *supra* note 99, at 1.

105. *See* 7 U.S.C.A. § 7935(a)(1), (c)(1)(A)–(B) (noting that a producer may agree to forego obtaining the loan in return for loan deficiency payments in the amount of the difference between the loan rate and the prevailing market price).

Deficiency Payment. LDPs are made from the time of harvest until May 31st of the following year for corn and soybeans.[106]

The LDP is a production-based subsidy; hence, it is variable with the amount of commodity produced. There is a tremendous risk of liability to the government if commodity prices fall below the loan rate. A 4,000 acre farm producing 500,000 bushels of corn yearly is eligible for a $250,000 subsidy if the market price is $0.50 below the loan rate. This risk became painfully obvious in the late 1990s when corn and soybean market prices were thirty to forty percent below the loan rates.[107] In response to ballooning LDPs to the largest producers (ostensibly those in least need of such payments), Congress enacted a cap on LDPs at $75,000 per year, per producer.[108]

b. Effects on Producers

The LDP seeks to solve the problem of low profitability by agreeing to pay more for the products struggling farms produce. However, directly subsidizing production also favors producers who do not need subsidies. The federal government attempts to act as a gatekeeper by enacting caps, which it hopes will screen out large producers who do not need subsidies.[109] Because the size of a farm is not necessarily a proxy for profitability, nor is it a proxy for non-family ownership, caps can also harm unprofitable and/or family farms, which is not the intent of Congress.[110]

The producer has the option of borrowing money directly from the federal government under the LDP program, but few choose to do so because of the increased transaction costs. Often, if the producer requires a loan at harvest, private interest rates will be competitive with the government loan rate, making two institutions redundant. The efficient choice (that is, least transactions) for a producer is to simply be paid the difference in the loan price, rather

106. *See* MAL & LDP FACT SHEET, *supra* note 99, at 5.

107. *See* NAT'L AGRIC. STATISTICAL SERV., U.S. DEP'T OF AGRIC., AGRICULTURAL PRICES 1997–98 SUMMARY 31–39 (July 1998) (noting the historically low prices for corn, soybeans and wheat in the late 1990s), http://usda.mannlib.cornell.edu/reports/nassr/price/zap-bb/agpran98.txt (on file with the North Carolina Law Review).

108. *See* 7 U.S.C.A. § 1308(d)(1) (stating that "[t]he total amount . . . that a person may receive during any crop year may not exceed $75,000").

109. The federal government also sees caps as a way of limiting spending, of course. *See* COMMISSION REPORT, *supra* note 2, at 19.

110. *See* 107th *Congress Hearings*, *supra* note 5, at 797–99 (statement of Rep. Chambliss) (noting that payment limitations hurt both profitable and unprofitable farmers, and noting the various devices used to avoid them, calling into question the efficacy of lowering payments by caps). For an in-depth analysis of payment caps under FSRIA see generally Kelley, *supra* note 72.

than take out an insufficient or unnecessary loan.

D. *Effects of a Direct Subsidization System*

The provisions of the FSRIA produce disparate economic results among producers, because payments differ depending on producers' level of production and profitability.[111]

Because a less profitable farmer is a greater credit risk, a private financial intermediary will usually charge a higher interest rate than a more profitable farmer would have charged. The higher interest rate makes the loan even more difficult to pay back, with the result that a greater proportion of a less profitable farmer's federal subsidy is going to pay back loans than would be the case for a more profitable farmer. In that sense, the federal subsidy is actually shifted from farmers to financial intermediaries, who benefit from an essential federal guarantee of at least a portion of the loan. Thus, a profitable farmer who pockets all or most of his subsidy gains a much greater utility from the subsidy than an unprofitable farmer who must use his subsidy to repay the bank at a higher interest rate. In this way, a federal subsidy can actually *accelerate* the demise of the very farmers it is intended to protect.

The caps on payments are partially intended to address this problem, by limiting the payment amount that large producers may receive.[112] However, the cap assumes that larger farms are necessarily more profitable farms, which may be untrue.[113] It has also been suggested that the caps disadvantage less profitable farmers, who lack the sophistication and resources to avoid the caps by complex restructuring methods, which more profitable producers routinely engage in to reap greater subsidies.[114] Since more profitable

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111. *See, e.g.*, *supra* Part I.C.2 (discussing DP variables and eligibility requirements); *supra* Part I.C.3 (discussing CCP variables and eligibility requirements); *supra* Part I.C.4 (discussing LDP variables and eligibility requirements).

112. *See* 7 U.S.C.A. § 1308 (capping payment of subsidies as a ceiling number based on aggregate payments made; since payments are based on production, the caps primarily affect those who produce the most). *See also* COMMISSION REPORT, *supra* note 2, at 102 (noting that larger producers who are affected by caps generally have lower production costs, and "smaller, less efficient producers may expand production ... under further payment limitations").

113. *See* COMMISSION REPORT, *supra* note 2, at 102 (admitting that lack of information regarding "cost differences by farm size" prevented reaching any conclusions on the effects of further limiting payment eligibility).

114. Congress has struggled mightily to close loopholes that allow producers to restructure farms into multiple entities to avoid payments caps. *See, e.g.*, 7 U.S.C.A. § 1308-1 (containing measures regarding the "prevention of creation of entities to qualify as separate persons; payments limited to active farmers"); *id.* § 1308-2 (preventing the use

producers may be more adept at gaming the system, they receive a disproportionate share of the benefits, again at the expense of less profitable producers.

Different crops are subsidized at different levels; for example, the higher relative target price for corn makes corn more lucrative than wheat.[115] For farmers with enough capital and sufficient growing conditions to diversify crops, planting decisions can be tailored to take full advantage of subsidies. For other farmers who lack the capital needed to buy specialized equipment for different crops, being caught with the "wrong" crop can spell disaster. The farmers who lack the deep pockets and abundant land to make crop switches to follow the programs are often the small family farms that the federal government purports to protect. The risk that a particular commodity will not be profitable is one every farmer assumes upon entering the market, but by favoring certain crops with larger subsidies, this risk is accentuated for farmers who lack the capital to diversify crops or whose farm land is not versatile enough to plant multiple types of crops.

Alternatives to production as a proxy for subsidization, such as family ownership or farm size, would be difficult to enforce, may foster counter-productivity and raise food prices, and may affect the global competitiveness of American agricultural products. A preferable alternative would identify and subsidize only those segments of the agricultural sector that most require it. Because producers by and large have equal access to markets to sell their

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of "schemes and devices"—an undefined offense—to circumvent payment caps). However, the difficulty of defining terms of ownership has thwarted most congressional efforts to limit payments to single controlling entities. *See, e.g.*, Brasher, *supra* note 60 (noting that although caps were nominally set at $150,000 [in 1999] a single landholding company received $2 million, the King Ranch received more than $630,000, and overall, two-thirds of the $27 billion in farm aid given in 2000 went to ten percent of producers). New for 2004 is a limit on gross adjusted income, contained in 7 U.S.C.A. § 1308-3a, which denies eligibility for subsidies to any entity which has gross income in excess of $2,500,000, "unless not less than 75 percent of the average adjusted gross income of the individual or entity is derived from farming, ranching, or forestry operations." *Id.* at § 1308-3a(b)(1). The efficacy of this limitation is dubious as well, since it is susceptible to the same structuring methods currently employed by producers to avoid payment caps based on production. *See* COMMISSION REPORT, *supra* note 2, at 101 (noting that farmers, in concert with "business advisors, lawyers, and others, are likely to develop a range of strategies to lessen the effects of further payments limitations").

115. Although the per bushel subsidy for corn is lower than that of wheat, the higher yield of corn gives it a higher net subsidy. As noted earlier, the disparate levels of subsidization for different subsidies may be the result of lobbying pressure brought to bear by groups with an interest in seeing a particular crop subsidized more heavily. *See supra* note 21 and accompanying text (discussing the lobbying efforts of special interest groups).

crops,[116] this Comment argues that the unfairness in the current subsidy system stems primarily from disparate access to cheap capital, not from a disparate price received for commodities. A system that seeks to equalize producers by paying them all the same price for their commodities, after the commodities have been produced, will only exacerbate the inequality between producers because it inherently rewards profitability instead of production. It is clear that the current federal subsidization method is failing farmer and taxpayer alike.[117] What is needed is equal access to cheap capital for all producers, so that production can be entered into on equal footing.

The following section outlines a series of transactions, known as securitization, that enable the flow of cheap capital from investors to producers.

II. SECURITIZATION OVERVIEW

A. Securitization Introduction

Asset securitization is a financial transaction in which one entity, an "originator," pools assets (typically income producing assets or receivables) and transfers them by sale to another entity, a "special purpose vehicle" ("SPV").[118] The SPV then issues securities collateralized, or "backed," by the transferred assets.[119] Public or private investors evaluate the risk of the assets cloistered in the SPV

116. The exception to this, as noted earlier, is the possibility that profitable producers may take advantage of market instruments such as futures contracts and options that less profitable producers may be unable or unwilling to use, thus giving profitable producers a greater utilization of market benefits. *See supra* Part I.C.3.b. However, this is a secondary effect from the primary benefit of cheaper capital.

117. *See* COMMISSION REPORT, *supra* note 2, at 1–9 (outlining the rising federal costs and rampant efforts to circumvent payment caps and recommending changes in payment caps and producer eligibility); *see also* COMMISSION REPORT, *supra* note 2, app. A at 132–35 (noting the cost of the federal agricultural subsidies through 2002); Elizabeth Becker, *Land Rich in Subsidies, and Poor in Much Else*, N.Y. TIMES, Jan. 22, 2002, at A14 (noting that farmers reap little of the benefit of increased land values as a result of subsidies because of liquidity issues).

118. *See* STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION 2–14 (3d ed. 2002) (outlining the basic structure of a securitization transaction); *see also* Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061–66 (1996) (same); Schwarcz, *supra* note 9, at 131–34 (same).

119. For example, with securities based on assets with an income stream deriving from accounts receivable for GM, the differing entities that owe money to GM (and now the SPV) will be graded and analyzed for their respective risk. The securities issued will be grouped according to projected risk, or alternatively, grouped so as to diversify risk. Schwarcz, *supra* note 9, at 134–36.

independent of the originator's financial or legal liabilities[120] and decide whether to purchase securities based purely on the merits of the assets backing them.[121] When the securities are sold to investors, the proceeds are used to pay the originator for the rights to the assets.[122] The income stream derived from the assets themselves is then used to pay investors a return on their investment.[123]

Transactions resembling modern-day securitization first occurred in the 1890s, when mortgage-backed bonds were sold to the public, and mortgage bankers issued mortgage participation certificates similar to modern mortgage-backed securities.[124] From the 1930s to the 1980s, the securitization market consisted mostly of home mortgages and other long-term loans.[125] The recent growth in securitizations was spurred in part by the federal government seeking to lessen the cost of capital for homebuyers.[126]

The assets used in securitizations vary widely; essentially any asset that currently is or will in the future produce income can be securitized.[127] Accounts receivables, the rights to royalties to David Bowie songs, tobacco settlements, and the rights to production from

120. This financial concept is known as "bankruptcy remoteness." Several commentators have questioned whether assets in an SPV are truly remote from the originator's creditors. For interesting analyses of the topic see generally Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996); Jonathan R. Macey, *Efficient Capital Markets, Corporate Disclosure, and Enron*, 89 CORNELL L. REV. 394 (2004); and Steven L. Schwarcz, *The Inherent Irrationality of Judgment Proofing*, 52 STAN. L. REV. 1 (1999).

121. Schwarcz, *supra* note 9, at 136.

122. *Id.*

123. *Id.* at 140.

124. *See* Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1380–82 (1991).

125. See Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1263–65 (1991) (describing the secondary mortgage market growth and securitization from the 1930s to the early 1980s).

126. Fixed-rate, level-payment mortgages were pooled into securities, backed by the full faith and credit of the United States government, and sold to investors. *See* FRANK J. FABOZZI, THE HANDBOOK OF MORTGAGE-BACKED SECURITIES 1–4 (1995); *see also* S. Rep. No. 91-761, at 1 (1970), *reprinted in* 1970 U.S.C.C.A.N. 3488, 3489 (enacting the Emergency Home Finance Act of 1970 in order to supplement "existing mortgage credit facilities" and to foster "new secondary market facilities to broaden the availability of mortgage credit"). For an example of more recent federal intervention see 12 U.S.C. § 1716 (1994) (stating that implementation of "secondary market facilities for residential mortgages" will facilitate the resale market in mortgages).

127. The Comm. on Bankr. and Corp. Reorganization of the Ass'n of the Bar of the City of New York, *Structured Financing Techniques*, 50 BUS. LAW. 527, 541 [hereinafter Bankr. Comm., *Structured Financing Techniques*].

oil fields have all been securitized.[128] Usually, securities are based on assets that are reasonably similar in type and level of risk, in order to give investors a consistent pool of assets to evaluate.[129] However, bundles of small assets can be pooled in an SPV in order to spread the cost of securitization between originators, or large assets can be allocated into several SPVs in order to make securities more affordable or homogenous in risk.[130]

A third party that has evaluated the risk may provide "credit enhancement" for the assets transferred to an SPV by guaranteeing the income stream generated by the assets.[131] Likewise, an SPV may be "over-collateralized," meaning that extra income producing assets are allocated to an SPV, providing a slight cushion of default before the income stream is interrupted.[132] Either method provides investors with an extra level of risk protection, which may result in a premium paid for asset-backed stock or a lower discount for asset-backed debt.[133] The premium translates into a lower cost of capital for the originator.[134]

B. Advantages and Risks of Securitization

In an ideal securitization transaction, every party to the transaction—originators, the entity controlling the SPV, and investors—will benefit. One commentator has gone so far as to characterize securitization as "alchemy" resulting in a cost reduction for the originator and reduced risk for the investor.[135] However, other commentators have questioned whether securitization of assets creates "extra" value and have theorized that originators may actually be harmed by the divestiture of the most valuable and liquid assets.[136]

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128. *See* Lisa M. Fairfax, *When You Wish Upon a Star: Explaining the Cautious Growth of Royalty-Backed Securitization*, 1999 COLUM. BUS. L. REV. 441, 459–61, 469–71 (1999) (noting the offering of bonds based on expected royalties from David Bowie songs); Charles E. Harrell et al., *Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques*, 52 BUS. L. 885, 885–86, 894–97 (1997) (describing the securitization of future revenues from the output of oil wells); Joni James & David Milstead, *States Mull Whether to Sell Stream of Tobacco Dollars*, WALL ST. J., August 2, 2000, at S1, *available at* 2000 WL-WSJ 3038697 (reporting the steps states had taken to securitize tobacco settlements).

129. Bankr. Comm., *Structured Financing Techniques*, *supra* note 127, at 537.

130. *Id.*

131. Schwarcz, *supra* note 9, at 136.

132. *Id.* at 136, 141.

133. *Id.* at 137.

134. *Id.*

135. *Id.* at 134.

136. *See* Panel Discussion, *Remember When—Recollections of a Time When Aggressive Accounting, Special Purpose Vehicles, Asset Light Companies and Executive Stock Options*

To an investor, securities based only on certain assets offer the advantage of risk containment.[137] Investors have less risk to analyze, since they can focus solely on the risks involved with the income stream underlying the assets; risks to the originator are severed from the assets, if an effective sale has been made to the SPV.[138] This containment of risk allows for efficient investment decisions, as well as reduced risk of default on the assets. Third party guarantees of the income stream or other risk-sharing mechanisms put in place by the SPV can further lessen risk to the investor.[139] Investors can diversify their investment by purchasing securitized assets from a number of different global industries.[140] The risks associated with securitization are not significantly different from those experienced in the everyday stock market; if anything, the risks are lessened (and the price of the securities higher) due to the customary level of risk insurance employed by SPVs.[141]

To an entity controlling an SPV, securitization offers similar benefits. Risk can be more easily identified and hedged against when assets are segregated from the originator.[142] An SPV can purchase assets from originators at a significant discount, especially if risky income streams underpin the assets.[143] Buying cheap assets with an investor's money represents little direct risk to the SPV, which functions as a clearinghouse and takes a margin on income stream production. Furthermore, an SPV can purchase risk insurance from third parties to cover the risk of income stream default, leaving the SPV with little direct involvement in the securitization other than as a

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Were Positive Attributes, 11 AM. BANKR. INST. L. REV. 1, 23–26 (2003) [hereinafter Panel Discussion, AM. BANKR. INST.] (statement of William Brandt) (lamenting the uses to which securitization had been put in order to defraud investors and bilk creditors); *see also* LoPucki, *supra* note 120, at 23–30 (outlining some of the pitfalls for creditors when securitization is used).

137. *See* TAMAR FRANKEL, 1 SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES 167–68 (1991).

138. *Id.*

139. *Id.* at 168.

140. *Id.*

141. *Id.* at 168–71. Risks typically associated with securities include risk of default altogether, liquidity risk (that is, that payment due on the securities will not be in full or on time), legal risk (risk that there will be legal liability incurred by the issuer of the securities), and market risk (that the value of the securities will decline). *Id.*

142. Schwarcz, *supra* note 9, at 138.

143. SPVs controlled by the originator are referred to as "one-off" SPVs; multi-originator SPVs are referred to as "multi-seller securitization conduits." *Id.* at 138–40. In this Comment, the entity controlling the SPV will be referred to as an SPV for ease of reference; technically, the SPV is only a tool used by the entity and not a separate entity.

structuring device.[144] An originator can even form an SPV simply to speed (or delay) realization of income for tax purposes, with no expectation of profit from the sale of securities.[145]

To an originator, the savings in net cost of capital enabled by securitization can be significant.[146] Because the assets involved often include future income streams, an originator will frequently sell the assets at a discounted price to reflect the current value and inherent risk of the assets.[147] However, securitization differs from a simple sale of the assets, such as "factoring," because the capital market provides cheaper and more abundant capital than private lenders.[148] Likewise, investors are often willing to pay a premium for assets that are segregated from the liabilities of the originators, since there is less risk associated with the assets.[149] This premium translates into more net capital raised by selling the rights to assets or an income stream than simply borrowing against them.[150] Assets will often remain in the control of the originator, allowing the originator to use its expertise in extracting the flow of income from the assets, as well as any intangible benefit the originator may draw from having operating control of the assets.[151] If the credit enhancement premium paid by investors is high enough, and the amount of assets securitized is large enough to offset transaction costs, the originator can lower its net capital cost.[152] The lower cost of capital can result in higher net profitability, further enhancing the originator's credit.[153] For large, closely scrutinized public companies, the balance sheet effects of securitization can also be beneficial, as the company will show a

144. *Id.* at 143–44.

145. For example, a firm in a cyclical industry may wish to bring forward revenue in a "down" year to offset loss, rather than pay increased taxes in the following year when there may be excess profits. By selling the rights to income before the actual income is realized, taxes can be paid sooner (or alternatively, delayed, if payment for the rights to the income is delayed) to fit the corporation's prerogatives. For a fuller discussion of the tax implications of securitization see SCHWARCZ, *supra* note 118, at 30–36.

146. *See* Hill, *supra* note 118, at 1007–94 (noting the effects of specialization, lower information costs, and reduced agency costs enabled by securitization).

147. *Id.* at 1091–93.

148. Schwarcz, *supra* note 9, at 144–45. Factoring is the sale of assets or an income stream to a private party and usually involves a greater discount than securitization. Factoring does not provide the same bankruptcy remoteness that securitization does because an SPV to hold the segregated assets is not formed. *Id.*

149. Hill, *supra* note 118, at 1091–92.

150. *Id.* at 1092–94.

151. SCHWARCZ, *supra* note 118, at 20–23.

152. Hill, *supra* note 118, at 1103–04.

153. *Id.*

higher return on equity and have more cash on hand.[154] Although the accounting sleight of hand enabled by securitization has come under increasing fire since the passage of the Sarbanes-Oxley Act,[155] the economic benefits of securitization are sufficient in their own right to ensure that the practice will continue to grow.[156]

Much has been written about the internal risks of securitization. The innovations in securitization have outstripped common law notions of property law and, to some extent, contract law.[157] As a result, questions have been raised about whether the assets in an SPV are remote from a potential bankruptcy of the originator, and whether sales to SPVs are in fact "true sales."[158] However, no serious efforts have been mounted in courts to challenge the securitization methodology, and legal risks seem to be limited to securitizations which are clearly attempts to skirt the law.[159] Another commentator has questioned the inherent efficiencies of securitization, implying that the transaction costs of securitization outweigh any benefit

154. SCHWARCZ, *supra* note 118, at 23.

155. *See generally* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.S.C. § 7201–66 (Supp. II 2000)). *See also* 36th Annual Institute on Securities Regulation, *SEC Summary*, 1455 PRAC. L. INST. 75, 79–80 (Nov. 11–13, 2004) (noting that previous accounting methods used to reverse the sale of loans and other assets are obviated and modified by § 401(b) of the Sarbanes-Oxley Act, and that new methods require additional and more prominent disclosure); Stephen L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539, 1549–50 (noting that § 401(c) and § 705 of the Sarbanes-Oxley Act required the SEC and the Comptroller General, respectively, to examine the usage of transactions involving SPVs).

156. *See* Panel Discussion, AM. BANKR. INST., *supra* note 136, at 3–6 (noting that despite the corporate scandals—in particular the deviously complex Enron schemes to securitize fictional income sources—that have tainted sophisticated financial transactions such as securitization, their use continues to grow); *see also* Schwarcz, *supra* note 155, at 1551–52 (stating that there are "fundamental differences" between legitimate securitization and Enron, including rampant conflicts of interest in the Enron deals, as well as the use of SPVs as a means of manipulating financial statements).

157. *See* Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163, 1165 (1999) (arguing that by protecting fragmented property rights as in a securitization the Supreme Court "paradoxically undermines the usefulness of private property as an economic institution and constitutional category").

158. *See* Stephen Schwarcz, *The Impact Of Bankruptcy Reform On "True Sale" Determination in Securitization Transactions*, 7 FORDHAM J. CORP. & FIN. L. 353, 353–56 (2002) (noting that new bankruptcy laws may change the way securitizations are structured, resulting in less protection of assets transferred to a SPV); *see also* Schwarcz, *supra* note 155, at 1542–44 (examining the possibility of legislation that would allow judges to redefine a sale as secured in certain instances, which would decrease an investor's certainty that a securitization transaction would be treated as a sale in bankruptcy).

159. *See* Panel Discussion, AM. BANKR. INST., *supra* note 136, at 14 (statement of Phillip Corwin) (noting that "[t]hough Enron gave a bad name to securitization, most are a very legitimate way for companies to obtain low cost credit and remain liquid").

conferred by cheaper capital.[160] However, the prevalence and increased regulation of securitization[161] seem to discount any concerns based on economic inefficiency.[162]

C. *Securitization of Agricultural Commodities*

Commodity-backed securities to date primarily involve situations where the income stream derives from the contractual obligations of a single large originator.[163] This is in stark contrast to many securitization transactions, where the underpinning income stream is composed of multiple obligors.[164] This makes the dearth of securitization options for farmers all the more perplexing, since there is no lack of demand for cheap capital.[165]

However, there may be several reasons why multiple-originator commodity-backed income streams are not prevalent in the United States. The transaction costs of securitization are formidable, making it inefficient for smaller originators to attempt them.[166] For many small producers in the United States, the local bank may still offer

160. *See* Edward J. Janger, *Muddy Rules for Securitization*, 7 FORDHAM J. CORP. & FIN. L. 301, 301–07 (2002) (arguing that the increased transaction costs of banding together originators and separating assets offset any benefit securitization may offer to multiple originator SPVs).

161. The SEC has recently proposed several new rules to regulate asset-backed securitization in particular. *See* Dow Jones Newswires, *SEC Is Set to Tackle Asset-Backed Paper*, WALL ST. J., Apr. 5, 2004, at A14.

162. *See* Schwarcz, *supra* note 158, at 363 n.48 (stating that "it would seem that for a type of financing as important and widespread as securitization, those attempting to set limits should bear the burden of producing persuasive empirical evidence that securitization is inefficient").

163. *See, e.g.*, Felipe Ossa, *Colombian Dealmakers Bank on Market's Sweet Tooth*, 3 ASSET SECURITIZATION REP., Feb. 24, 2003, at 20 (noting the securitization of sugar by a single large refinery), http://www.asreport.com/ (on file with the North Carolina Law Review).

164. *See, e.g.*, BANC ONE CAPITAL MARKETS, INC., STRUCTURED DEBT YEARBOOK 2004 24–33 [hereinafter BANC ONE YEARBOOK] (reviewing securitizations backed by credit card receivables), http://www.securitization.net/pdf/bankone_yearbook_26Jan04.pdf (on file with the North Carolina Law Review); *id.* at 38–42 (same for manufactured housing sales); *id.* at 65–67 (same for student loans).

165. *See Agriculture Credit: Hearing Before the Senate Comm. on Agric., Nutrition, and Forestry*, 107th Cong. 74–75 (2001) (Sup. Doc. No. Y4.AG 8/3:S.Hrg. 107-590) [hereinafter 107th *Senate Hearing*] (statement of Henry D. Edelman, C.E.O. Farmer Mac) (stating that "as risk has increased, a number of lenders have become increasingly capital constrained and have tightened underwriting requirements that make it difficult or impossible for some farmers who urgently need credit to obtain it with competitive rates and terms"), *available at* http://agriculture.senate.gov/Hearings/Hearings_2001/May_16__2001/0516ede.htm (on file with the North Carolina Law Review).

166. *See* FRANKEL, *supra* note 137, at 121–22 (noting that pooling can increase debt and costs if an increased number of originators is not offset by economies of scale).

cheaper capital than would be available through a private securitization.[167]

Another difficulty lies in the actual structuring of a multiple-originator agricultural commodity securitization. Much of the structuring will involve original work by lawyers and financiers, which is expensive and risky. It may be that firms that underwrite securitizations generally prefer to use market-tested methods and principles that ensure a reassuringly boring (and lucrative) securities offering, such as one based on credit card receivables. Additionally, finding third party guarantors may be difficult because assessing and allocating risk can be notoriously difficult in the commodities market, where producers are subject to both significant price risk and catastrophic weather risk.[168] Although futures, options, and other derivatives offer a hedge against these risks, firms may be reluctant to structure an entity without a solid market precedent. Consequently, because of the inherent risk in commodities production, and because of the relatively uncharted territory, commodity securitizations have remained a largely untapped source of capital for producers.

The barriers to such a securitization are not insurmountable. The current market conditions in the agricultural industry are not unlike those in the mortgage industry in the late 1970s, when the federal government stepped in and sponsored securitizations of home mortgages in order to provide new capital markets for homebuyers.[169] A similar intervention in the agricultural industry is warranted, especially given that the federal government has a direct interest in ensuring that producers have access to cheap, timely capital. The following discussion outlines some of the issues unique to an agricultural commodities securitization.

D. Agricultural Commodities Securitization Model

Despite the scarcity of multi-source commodity securitizations, valuable instruction can be drawn from examples of securitization of similar income producing assets (such as oil production receivables generated by oil wells). The following discussion introduces some of the basic concepts involved with commodity securitization.

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167. Cheap, but not cheap enough. *See* 107th *Senate Hearing*, *supra* note 165 (noting that despite efforts by the federal government to offer favorable loans to farmers, many still were not able to receive enough money at favorable rates to stay competitive).

168. *See infra* Parts II.D.2.a–b.

169. *See supra* notes 124–26 and accompanying text.

1. Interests on Which a Commodities Securitization May Be Based

a. Production Payments

"A production payment constitutes a right either to a specified share of the production from [a given plot of land] (a volumetric production payment) or to the proceeds from the sale of that production (a monetary production payment)."[170] If the production payment is used to support a securitization, the right to payment is sold by the producer to an SPV.[171] The rights to the production payment are purchased from the originator by the SPV with funds obtained from equity or debt investors accessed in a capital markets transaction.[172] Once the rights to the production payment have been transferred to the SPV, the producer no longer has rights to the proceeds of the transferred interest.[173] The security holders look exclusively to proceeds from production for payment of a return on investment, with no recourse to the producer.[174]

b. Forward Sale and Purchase of Commodities

A forward sale occurs when a commodity owner (or lessee of commodity rights) agrees to sell certain commodities at a given point in the future at a given price to an SPV in exchange for an immediate cash advance.[175] The SPV will then issue securities based on the rights to purchase the commodities at a given price.[176] For an investor, purchase of this security is essentially no different from buying the futures contract themselves on a commodity exchange,[177] except for the diversification an SPV offers.[178] Third party guarantees of securities backed by forward contracts can bolster risk coverage in

170. *See* Harrell et al., *supra* note 128, at 893 (noting the structure of future flow oil securitizations and cataloguing the risks).

171. *Id.*

172. *Id.* The funds necessary to purchase the assets from the originator could also be borrowed from banks or other private financial intermediaries. *Id.*

173. *Id.*

174. *Id.*

175. *See id.*

176. *See id.*

177. Several commodity exchanges in the United States offer contracts in single types of commodities in varying denominations and amounts. *See, e.g.*, *Chicago Board of Trade*, *at* http://www.cbot.com/ (last visited Mar. 2, 2005) (discussing the fact that most agricultural commodities, such as grains, livestock, and agricultural inputs like fertilizer, are traded on the Chicago Board of Trade) (on file with the North Carolina Law Review).

178. For instance, while an investor could purchase the right to delivery of a 5000 bushel soybean contract, such a contract would not offer the same risk mitigation that a security based on five million bushels deriving from several different producers would.

order to maximize value to investors.[179]

c. Receivables Generated from Sales of Commodities

Producers generate receivables when they sell commodities,[180] as do grain elevators and other intermediaries.[181] Whether arising from "cash" sales or sales under forward contracts, receivables constitute the asset that most frequently underlies commodity securitizations.[182] However, as noted before, multiple-originator securitizations of this type have been limited in size and success.[183]

2. Commodities Securitization Risks

Securitizations of commodities present a number of risks. It is crucial that these risks be identified and minimized in order to receive a favorable credit rating. Without a favorable rating, investors will steer clear of the offering, and any hope an originator has of raising cheap capital will evaporate.[184] Credit ratings are assigned to securities by rating agencies, which evaluate securities at the request of the issuer.[185] "The ratings represent the agency's opinion as to the credit risk associated with a security and the likelihood that the security will be repaid timely."[186] Following are some of the risks analysts consider when rating securities based on future income streams, the securitization type that this Comment recommends the federal government sponsor.

a. Production Risks

The value of future income from production depends partially on the quantity of the commodities being produced. In the context of agricultural production, a primary risk associated with production is weather.[187] The federal government recognizes and attempts to

179. Harrell et al., *supra* note 128, at 888–89.

180. *See id.* at 897.

181. A grain elevator is an entity that purchases and stores commodities. The elevator may be owned by the end user of the commodity, or it may be a third party that purchases from producers and sells to end users. *See* Harter v. Iowa Grain Co., 220 F.3d 544, 547 (7th Cir. 2000) (explaining that contracts between farmers and grain elevators "guarantee farmers a buyer for their grain and guarantee grain elevators a supply of a commodity").

182. *See id.*

183. *See supra* Part II.C.

184. *See* Harrell et al., *supra* note 128, at 900.

185. *Id.*

186. *Id.*

187. *See* RISK MANAGEMENT AGENCY, U.S. DEP'T OF AGRIC., INTRODUCTION TO RISK MANAGEMENT 6 (Dec. 1997). The USDA lists pests, disease, the interaction of technology with other farm and management characteristics, genetics, machinery

address this risk by repeated passage of "emergency" bills to give relief to farmers stricken by weather disasters, such as a drought or hurricane.[188] Weather disasters can be localized, such as a hailstorm or lightning-induced fire, or they can be more widespread, such as a drought or a hurricane. Although meteorological technology has grown apace with general agricultural advances, it is still difficult to anticipate with any local particularity the weather risks of an entire growing season. The critical determination for an investor is what level of production risk is acceptable in an investment.[189]

Additional production risks unique to agricultural commodities are also difficult to analyze and quantify.[190] Predicting how and where disease or insect depravation will occur remains problematic, at least on a localized basis. Other industries that have securitized commodities, such as oil production, have developed sophisticated risk analysis tools that incorporate several individualized factors,[191] but the essential difference remains that reserve risk of an underground oil deposit can be calculated much more accurately than production risk to a corn crop that is subject to the vagaries of weather and disease. Hence, an agricultural commodity securitization will require a substantial level of risk guarantee to be attractive to investors.

b. Price Risks

The level of price risk that ratings agencies (and investors) must assess depends on the nature of the assets acquired by the SPV. If the

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efficiency, and the quality of inputs as other "major" production risks. *Id.* The USDA has an extensive weather analysis website designed to measure and quantify risk. U.S. DEP'T OF AGRIC., JOINT AGRICULTURAL WEATHER FACILITY, *at* http://www.usda.gov/agency/oce/waob/jawf (Aug. 8, 2004) (on file with the North Carolina Law Review).

188. In 1999 through 2000, Congress provided five emergency aid bills that added $29.6 billion to existing funding for agriculture, partly in response to weather disasters which affected yields. *See* Jean Yavis Jones et al., CONGRESSIONAL RESEARCH SERVICE, CRS REPORT FOR CONGRESS: WHAT IS A FARM BILL? 11–12 (May 5, 2001) [hereinafter CRS REPORT], http://bennelson.senate.gov/Crs/farmbill.pdf (on file with the North Carolina Law Review). Disaster aid is not solely to farmers, of course, but as farmers stand to lose not only personal possessions but means of livelihood as well, a substantial amount of weather related disaster relief assistance is directed at farmers.

189. *See* Harrell et al., *supra* note 128, at 899–900 (noting that production risk "must be addressed in a manner acceptable to the originator and a rating agency if the related securities will be rated.").

190. For example, in each of the past several years, one-half to two-thirds of counties in the United States have been declared agricultural disaster areas. FARM SERV. AGENCY, U.S. DEP'T OF AGRIC., CROP DISEASE ASSISTANCE, *at* http://disaster.usda.gov/crop_jump.htm (last visited Jan. 31, 2005) (on file with the North Carolina Law Review).

191. *See* Harrell et al., *supra* note 128, at 898–903.

commodity production acquired by the SPV is to be sold on the open, or "spot," market rather than under long-term forward contracts, the future market for such production must be evaluated.[192] Just as price drops can skew the projected cost of subsidies programs, unexpected price drops can significantly affect the economics of a commodities securitization. A securitization based on a volumetric or cash price forward contract requires that investors (and any guarantor) assume a commercial risk.[193] For example, a security based on the production of an acre of land is subject to the risk that the price for the commodity produced on that land will go down. If the risk can be foreseen or anticipated, the price of the security will be discounted to reflect such a risk.[194] However, given the nature of the commodity market, many investors may also wish to employ a hedge; that is, purchasing or selling financial instruments that further diminish risk.[195] A variety of hedges are available on the commodities market, usually in the form of options.[196] As an alternative or in addition to a hedge, a rating agency may utilize a worst-case price assumption in valuing the assets and discount the securities to provide a "cushion" to investors.[197] The price of the security will reflect both the level of risk and the cost of hedging against it, and if the price risk is too great, the resulting low price of the security will not justify the securitization.[198] As the amount of transactions increase (and hence the cost of the securitization), the likelihood that it will be cheaper for the originator simply to borrow funds from the private market also increases.[199]

c. Operator/Management Risks

Producers who generate the future commodity receivables acquired by the SPV must have sufficient financial and technical expertise to manage the assets.[200] Analysis of the commodity-backed securities proposed in this Comment will have to take into account the wide range in management and profitability of American farms.

192. *Id.* at 901.
193. *Id.*
194. *Id.*
195. *Id.*
196. *See supra* notes 97–98 and accompanying text (explaining how options may be used to employ hedges in the commodity market).
197. Harrell et al., *supra* note 128, at 901.
198. *See* FRANKEL, *supra* note 137, at 160–62 (noting that there is a threshold cost of securitization beyond which private capital may be cheaper for the originator).
199. *Id.*
200. Harrell et al., *supra* note 128, at 900–02.

A wealth of county, state, and national data has been compiled by the federal government in the administration of the subsidization program, and this information could be used to analyze yield data, rate of loan default, and other factors in determining the risk of a given portfolio.[201]

d. Political Risks

The political risks of a commodity securitization in the United States are partially hidden but very real. While in developing countries the risks of expropriation or regime change wilt the ardor of investors, in the United States the risks center around policy shifts and administration philosophy. While these "soft" risks may not grab headlines in the same manner as bombs falling on Baghdad, they have an effect on agricultural production and industry direction.

The wavering policy goals of subsidization in the United States offer a good example of what political risks a private agricultural securitization may face.[202] Programs to take land out of production or subsidies based solely on land ownership may be disincentives to production,[203] which could affect the attractiveness of volumetric or other production-based securities. On the other hand, the crop insurance that the federal government provides to producers[204] may offer an extra level of safety for investment in production, a sort of free hedge against disaster. In either event, any agricultural securitization requires careful analysis of the industry as a whole, as well as examination of individual originators.

The external legal risks of a commodities securitization are the legal risks unique to the particular industry from which the commodity is derived. The laws and regulations, particularly environmental legislation to which farms are subject can provide disincentives for production.[205] Zoning laws have become

201. *See* FEDSTATS, STATISTICAL AGENCIES, *at* http://www.fedstats.gov/key_stats/ERSkey.html (last visited Nov. 7, 2004) [hereinafter FEDSTATS] (noting the various types of financial information on farmers kept on file by the federal government, including farm structure, income and performance) (on file with the North Carolina Law Review).

202. *See supra* Part I.B (examining the history of the federal subsidization of agriculture in the United States).

203. *See supra* note 68 and accompanying text (noting the inclusion of conservation and crop insurance titles in FSRIA).

204. *See id.*

205. *See generally* 33 U.S.C. §§ 1251–1387 (1994) *and* 42 U.S.C. §§ 300f to 300j-26 (1994) (regulating the usage and distribution of water). *See also* 7 U.S.C. §§ 136–136y (1994) (regulating the usage and distribution of herbicides and pesticides); 16 U.S.C. §§ 1531–1544 (1994) (regulating land use, particularly wetlands, under the auspices of the Endangered Species Act); 16 U.S.C. §§ 3831–3836 (1994) (containing the provisions of the

increasingly relevant to farmers with the accelerating urban encroachment on agricultural land and can have a significant impact on the type and size of agricultural operations permitted.[206]

III. FEDERAL SECURITIZATION OF AGRICULTURAL COMMODITIES

The federal government has found that maintaining an agricultural subsidization system is increasingly difficult due to the inherent inefficiency of direct subsidies.[207] Because the federal government will be subsidizing American agriculture for the foreseeable future, it should strive to support agriculture in the most efficient and effective manner possible.

The disincentives to securitization present for private parties also exist for the federal government, but to a lesser degree, due to the investment the federal government already has in agriculture. The potentially high cost of banding together multiple-originators has already been offset by the gathering effect of the subsidy programs.[208] The weather, disease, and operator risks present in a securitization are already undertaken by the federal government, in effect, by the current subsidy program. Existing farm agencies already work closely with producers and, because they are deeply familiar with the policy and procedures of a subsidy program, would be well qualified to implement and administer a securitization subsidy regime once it is structured.[209]

Most compellingly for the federal government, the increased efficiency of a securitization may lower the costs of subsidization,

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Conservation Reserve Program, designed to take land out of production).

206. For an overview of the difficulties farmers face from municipal zoning ordinances, see generally Patrick J. Skelley II, Note, *Defending the Frontier (Again): Rural Communities, Leap-Frog Development, and Reverse Exclusionary Zoning*, 16 VA. ENVTL. L.J. 273 (1997).

207. *See supra* Part I.D (noting that under the current system, payment limits are bypassed by structuring a single farm as multiple entities, as in a cooperative, thus giving a disproportionate share of subsidies to entities sophisticated enough to manipulate the system); *see also* Brasher, *supra* note 60 (noting that giant farms bypass federal payment limits to the detriment of smaller farmers).

208. Eligibility requirements ensure that the federal government has information on all farms currently receiving subsidies. *See supra* Part I.C.; *see also* FEDSTATS, *supra* note 201. Pooling assets into an SPV is essentially the transfer of information and obligations. FRANKEL, *supra* note 137, at 287–95. It is a relatively small step for the federal government to shift its obligations from single farmers to farmers within the SPV.

209. Since the essential function of facilitating and administering federally sponsored payments to farmers would remain largely the same, the FSA would likely have little difficulty shifting from a direct payment system to one utilizing securitization. *See supra* note 79 and accompanying text (describing the functions of the FSA).

market prices being equal.[210] The following proposal outlines the actions the federal government can take to make federal securitization of agricultural commodities a reality.

A. *Federal Securitization Model*

1. Transaction Structure

Initially, the federal government will have to provide the impetus to securitize agricultural commodities from multiple originators.[211] This can be accomplished primarily by the creation of a federally sponsored SPV. The SPV will gather together the multiple producers of commodities who will provide the income stream on which the securitization will be based.[212] Producers will sell the rights to the production of a given amount of land in a given commodity to the SPV; for instance, rights to the production of an acre of corn. The income stream from these units of land will be structured into securities, which can be sold to investors. In order to move payment forward to the farmers, securities based on revenue received at harvest should be issued early in the growing season.[213]

The investor will then be paid at harvest time out of the proceeds from the sale of the commodities. Although harvest and time of sale will depend on the type of commodity, the length of the investment will be roughly consonant with the growing season: six to nine months, depending on the crop.[214] As the commodity is harvested

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210. Should payments be equal to current direct subsidies, the federal government will still benefit from the delayed payment enabled by a securitization. If the securities reach their floor price without governmental assistance, then the federal government has no cost other than that associated with structuring the SPV. *See infra* Part III.A.1.b. In the current direct subsidy system, the DP is made regardless of market prices, ensuring some level of governmental liability. *See supra* Part I.C.2.

211. *See supra* note 126 and accompanying text (noting a similar invigoration of the secondary market in home mortgages).

212. Thomas J. Gordon, Comment, *Securitization of Executory Future Flows as Bankruptcy-Remote True Sales*, 67 U. CHI. L. REV. 1317, 1322 (2000) (stating that SPVs can base the issuance of securities on expected future flows of income).

213. For instance, for corn harvested in October, securities need to be issued in the spring to offset the planting and operating expenses of the producers.

214. For corn, the growing season in the United States is roughly from April–May to September–October. *See* NAT'L AGRIC. STATISTICS SERV., U.S. DEP'T OF AGRIC., USUAL PLANTING AND HARVEST DATES FOR U.S. FIELD CROPS (Dec. 1997), http://usda.mannlib.cornell.edu/reports/nassr/field/planting/uph97.html (on file with the North Carolina Law Review). For soybeans, the growing season depends on the variety and ranges from six to nine months in length. *Id.* For wheat, the growing season also depends on variety and ranges from seven to ten months. *Id.* The federal SPV will have to take the growing season variance into account when determining time of payment to

and marketed, payment will be made to the federal SPV on the portion under obligation. The SPV will then allocate the agreed level of payment to investors. In this manner, the producer is essentially paid for a significant portion of its crop at or before the point of planting, providing the producer with sufficient capital to operate.[215] The investor is guaranteed a favorable level of return on a reasonably short-term investment.[216] The federal government has no financial obligation at the point of planting and, with favorable market prices, none at all beyond the cost of structuring the securitization.

a. Originator Analysis: Production and Price Risk

The yield history of the farms required to calculate base acres under the current subsidy system[217] can be used as a proxy to determine the range in which future production will fall. This range of production can be estimated with reasonable particularity on a large scale, as evidenced by the close estimates regarding acres planted and national yield produced by the federal government.[218] This large-scale accuracy offsets the individual difficulty that has to this point deterred private securitizations.[219] Once an estimate of total production has been made, the federal government can calculate what level of commodity production (the volumetric estimate) is eligible for securitization.[220]

Price risk will be more difficult to assess, as the federal

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producers and investors.

215. *See* Gordon, *supra* note 212, at 1320–21 (noting that in a future income stream securitization, the originator is paid for the "sale" of assets before the assets generate income).

216. *Id.* at 1342–43.

217. *See supra* Part I.C.2 (outlining the calculation and usage of yield history data in determining DP eligibility).

218. The federal government routinely makes agricultural production estimates, often for as far as ten years into the future. *See* INTERAGENCY AGRIC. PROJECTIONS COMM., U.S. DEP'T OF AGRIC., AGRICULTURE BASELINE PROJECTIONS TO 2013 24–27 (2004) (noting the expected planted acres of corn soybeans and wheat until 2013), http://www.usda.gov/oce/waob/commodity-projections/2013projections.pdf (on file with the North Carolina Law Review).

219. This spreading of risk over a larger pool is a major advantage of securitization. *See supra* Part II.B. In the context of commodity production, having multiple originators may allow for shortfalls in certain geographical areas, whether caused by weather, disease, or operator failure, to be made up for by increased production in other areas due to the same variables.

220. For example, if the government will guarantee seventy-five of projected planted corn acres at seventy-five percent historic average yield, then a projected planting of 1000 acres of corn with a historic yield of 120 bushels to the acre will be eligible to securitize the production of 750 acres yielding ninety bushels; 67,500 bushels.

government has found in past attempts to set target prices.[221] However, the information needed to analyze the potential market price for a commodity is already available to the federal government, and securitization will allow the analysis to be conducted on a rolling basis, as securities are issued.[222] By calculating a price at which to guarantee the income stream more often than is currently done in the subsidy program, a more accurate analysis can be made, since new information can be added to pricing models more frequently.[223] Because of the greater volume of bushels being covered and the earlier payment to producers enabled by securitization, the payment per bushel in a securitization may not need to be as high as the target price is in the current subsidy program.[224]

b. Security Structure

Once production and price risk have been analyzed and estimated, the government can begin to structure the securities to be issued.

Perhaps the simplest and most effective structure would be to sell the rights to a given amount of production from a given plot of land, a volumetric production payment.[225] Because the existing information and infrastructure regarding commodity production in the United States is measured in production per acre, the basic unit on which a security could be based is the right to the commodity production of an acre of land for one growing season.[226] These rights may be pooled into a federally sponsored and administered SPV and repackaged and sold to investors as securities.

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221. *See supra* Part I.B (noting the over-runs of the federal subsidy programs, attributable in part to governmental liability incurred when market prices fell below target prices).

222. *See supra* Part I.C (noting the information required of farmers in order to receive subsidies); *see also* FEDSTATS, *supra* note 201 (providing information on American farms ranging from demographic to financial).

223. It is also reasonable to expect that private market analysis of the commodity market will increase as the securities become available on the market and investor interest is generated. As increasing information is sought out and made available, it is possible that prices may be predicted more accurately. For an analysis of the interplay between market prices and farm conditions, see generally Douglas W. Allen & Dean Lueck, *The Nature of the Farm*, 41 J.L. & ECON. 343 (1998).

224. For instance, if the target price for corn is dropped from its current level of $2.60 to $2.00, the producer in the prior example will still be eligible for a payment of $135,000 at the beginning of the crop season, as opposed to a payment six months after harvest that may be subject to caps.

225. *See supra* note 170 and accompanying text.

226. For example, the right to the proceeds of corn production from an acre of land for the growing season of 2005.

Securities that incorporate some aspects of both volumetric production and fixed payment will be attractive to investors only if there is a level of guarantee of both production and price risk.[227] For example, a security based on the production of a given amount of land planted in corn bears both the risk that the corn will not be produced, and the risk that the price upon which the value of the security is based will decline.[228] To offset the uncertainty inherent to income stream estimates, the federal government may provide a level of assurance to the investor by guaranteeing payment at a certain level.[229]

A "floor" price can be established based on the estimated minimum value of the income stream, and the government will guarantee that this price will be paid for commodities regardless of the market price of the commodities when sold. If the government wants a higher price paid for the securities (and hence more capital to producers), it can raise the floor of the security to the desired level. Of course, by raising the floor, the government assumes more risk in the event that production falters or price drops. This risk could be passed on to private insurers for a fixed fee paid at the time of the securitization, or the government can bear the risk itself.[230]

Leaving marketing in the hands of the producers allows the marketing to be done by the party best suited to sell the commodity, since the producer would be able to dispose of the commodities more efficiently than would the federal government.[231] The producers already have infrastructure in place to store and market

227. *See* Harrell et al., *supra* note 128, at 888–89 (noting that commodity-backed securitizations usually require some sort of third party guarantee due to their inherent risk).

228. *See supra* Parts II.D.2.a–b (explaining production and price risk in commodity securitization).

229. *See* FRANKEL, *supra* note 137, at 359–401 (listing the types of third party guarantees typically employed in securitizations, such as an independent party agreeing—for a fee—to insure that the income stream from a particular pool of asset will maintain a certain level).

230. The fact that the government already bears similar risk in the CCP and LDP programs suggests that it will wish to bear the risk itself in order to minimize expense to itself at planting, even if risk of future payment is higher. *See supra* Parts I.C.3–4 (outlining provisions of the CCP and LDP portions of the subsidy program).

231. *See* TAMAR FRANKEL, 2 SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES 91–97 (1991) (noting that when the originator is the servicer of the pool, this may create efficiencies that cannot be duplicated by hiring an outside source to oversee the management of the income streams); *see also* Gordon, *supra* note 212, at 1335 (stating that "[i]t is more efficient for the SPV to hire the originator as its collection and administration agent than to collect and administer the accounts by itself").

commodities—storage facilities, transportation equipment, and personal contacts—that the federal government would have to duplicate if the commodities were purchased outright from the producer at harvest. Simply buying the rights to the commodities allows the physical growing, marketing, and delivering of the commodities to be handled by the producer.[232]

A potential problem with selling income rights to the federal SPV is that doing so lessens the producer's incentive to sell the commodity for the highest possible price. This hurts the federal government, which must make up any shortfall between the floor price and the price received on the market. However, if the amount received at the point of sale exceeds the floor price, in a traditional securitization, the investor would benefit from any appreciation in the security due to higher production or price. The difficulty with allowing the investor to reap the entire benefit is that it destroys the producer's primary incentive to market the commodity profitably: the producer has already received its payment and will be economically indifferent to the price paid at market.

In order to provide the producer with an incentive to seek the highest possible price for the commodity—that is, to maintain the efficiency of the market—a "ceiling" should be placed on the commodity-backed security as well. This ceiling would be the maximum amount an investor would be entitled to receive under the security agreement. Determining the ceiling would be a policy consideration similar to that involved with setting the floor price.[233] Revenues received beyond the ceiling price would be absorbed by the federal SPV, which would then distribute the excess revenues to producers as a bonus. By rewarding effective production and marketing in this way, the efficiency of the market could be preserved.

For instance, consider a security based on the production of one acre planted in corn, with a floor price of $2.70 per bushel and floor production of 120 bushels. Such a security would have a face value of $324.00 at the time of its issuance.[234] Should the price of corn increase

232. *See supra* note 151 and accompanying text (noting that allowing the assets to remain under the control of the originator may reap the benefits of the originator's expertise in managing them).

233. However, instead of choosing a static floor and ceiling price at the inception of a farm bill that lasts for the duration of the bill, the market and production indicators would be analyzed yearly, and the floor and ceiling prices for each production year would be adjusted according to the goals of the federal government.

234. Like all securities based on a payment to be made in the future, the value of the security would likely be discounted at issuance to reflect the time value of money. The

to $3.00 per bushel, and production rise to 150 bushels, the security would be worth $450.00, an increase of $126.00 from the floor price. If the ceiling price were $2.85 and the ceiling yield were 140, the investor would be entitled to $399.00, and the federal SPV would retain $51.00. The surplus above the ceiling value would then be returned to the producer at whatever bonus ratio the federal government establishes.

Should the price of corn drop to $2.50 per bushel, and yields only reach 100 bushels nationally, the securities would be worth $250.00, a decline in value of $74.00 below the floor value. The federal government would be obligated to cover this shortfall to investors. The producer would have already received a payment of $324.00 per acre at the time of issuance and would be the benefactor of an effective subsidy of $74.00 per acre, softening the blow of lower prices and yield.

2. Benefits and Risks to Originator/Producer

For producers, the primary benefit is precisely that not offered by the current subsidization structure: access to cheap capital, when needed. By moving payment for the crops forward to when the producers are incurring costs, rather than paying the bulk of the subsidy post-harvest, borrowing costs for the producer are lessened and perhaps eliminated.

By subsidizing access to capital rather than land ownership and raw production, the playing field would be leveled for producers. Although the gross subsidy will still be larger for higher production, less profitable producers would no longer have to borrow at a higher interest rate to make ends meet.[235] Subsidization of producers would be more of a voluntary choice for those who wish to make an investment, rather than the current system of involuntary subsidization by all taxpayers.[236]

By aggregating the commodities in the SPV, credit is extended to producers as a whole by investors. The effect of such a structure

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amount of the discount would depend on several factors, including the prevailing interest rate and the risk inherent to the security.

235. *See supra* Part I.D.

236. Of course, whatever level of federal participation remained in a securitization structure—that of structuring and administrating the SPV, and providing some level of guarantees—would be at the cost of taxpayers at large. At its inception, securitization would lessen, not eliminate the tax burden, although in the long-term, private securitization may begin to obviate the need for federal participation, similar to the home mortgage market (which still has a significant level of federal participation). *See supra* notes 124–26 and accompanying text (discussing the home mortgage market).

would be that high profitability operations would subsidize lower profitability ones, by giving them the benefit of a higher aggregate credit rating.[237] Shifting part of the cost of the subsidy from the federal government to profitable producers may eventually result in the more profitable producers leaving if cheaper capital becomes available, perhaps through private securitizations. However, this would be a positive effect for the federal government, whose net costs would be lowered because less of the crop would need to be guaranteed. The remaining producers who would be subsidized would be those who need, and arguably deserve, the subsidies most. The gradual winnowing effect of encouraging profitable producers to seek cheaper capital while at the same time supporting struggling producers is a characteristic of securitization that cannot be matched by direct subsidies. By subsidizing a farmer's access to capital rather than his production, the problem of high borrowing costs is addressed at its root rather than its result.

Securitization could also lessen the impact of disasters on farming operations, because there would be capital on hand to deal with the disasters. Unlike current emergency provisions, which can take years to give aid, farmers would have more capital on hand to rebuild or replant after a disaster.[238]

Farmers would also have the ability to borrow more from local banks to meet costs, whether normal or catastrophic, because their effective credit ceiling would be higher. The federal guarantee of income to farmers would enhance their overall profitability and make them more attractive to lenders. Mitigating the cash flow problems inherent to a cyclical industry would enhance the overall equity value of farms, permitting farmers to borrow the large amounts necessary to purchase land and equipment.

Securitization potentially lowers the cost of marketing for the farmer. By allowing the bulk of the crop to be sold prior to or in conjunction with planting, without the price risk associated with futures contracts, farmers could avoid many of the transaction costs associated with taking their goods to the market. Any subsequent gain in the market price would be returned to the farmer pursuant to ceiling caps.

Because farmers receive reciprocal SPV payments if the price of

237. *See* FRANKEL, *supra* note 137, at 167–68 (noting that investors also benefit from diversified originators and pools).

238. *See supra* Parts I.C.2–4 (outlining the timing of payment under current direct subsidies); *see also* CRS REPORT, *supra* note 188 (noting the various emergency bills enacted in the past decade).

the security exceeds the ceiling, they have a strong incentive to produce and market effectively. Farmers are in an ideal position because the federally sponsored SPV assumes the obligation to pay investors if production or prices falter, and if the security increases in value past the ceiling, then farmers will receive a percentage of the excess.

3. Benefits and Risks to SPV/ Federal Government

The most compelling benefit to the federal government of securitization is the savings it will enable. By shifting the cost of capital to the public markets, the government will potentially limit its costs to those associated with structuring and maintaining the SPV.[239] If market prices and production stay at favorable levels, then the federal government will not be required to step in as a guarantor, and the money usually carved out of tax revenue will simply be paid from investor to producer. This would benefit the federal government tremendously, since the transactions associated with taxing and distributing capital are replaced by the more efficient distribution of capital enabled by the private financial market.[240]

If the government is compelled by low prices or production to honor its guarantee, deferring payment until after harvest allows payment to investors to be delayed until additional tax revenues are also realized.[241] The burden of deferment is borne by investors who do not have the immediate capital requirements of farmers. Even if the net payment made by the government in a securitization approaches that made in a direct subsidy, it will still reap the benefit of deferment. In effect, because a security is purchased by an investor at the beginning of the growing season, and payment is not due until harvest, the government receives a low interest loan from investors, at a rate more favorable than if the government had to borrow to fulfill its obligations under the current subsidy system.

Shifting the burden of raising capital for subsidization programs to the private market could have far-reaching effects. Foreign investors are already enamored with the security and stability of

239. FRANKEL, *supra* note 137, at 360–63 (noting that guarantors have no liability unless the conditions of the guarantee are not met).

240. Schwarcz, *supra* note 9, at 149–50 (noting the relative low cost of financing capital markets).

241. FRANKEL, *supra* note 137, at 360–63 (noting that guarantors have no liability until there is an interruption in the underpinning income stream, or some other conditions of the guarantee are not met).

United States markets[242] and would likely view American agriculture as a similarly attractive proposition.[243] Transferring production and price risk to foreign interests while retaining the safety and security of a key component of the American economy should be an enticing prospect for the federal government.

The costs of implementing a securitization are partially offset by existing features of the subsidy system. The information needed to structure the income stream is already largely available to the federal government, because the type of information gathered to determine eligibility under the FSRIA is the same information needed to analyze the risks associated with an agricultural securitization: historic yield, rate of default, median farm income, along with a host of more individualized factors.[244]

4. Benefits to Investors

The benefits to investors of a federally backed commodity securitization would include all the benefits normally associated with securitization: diversification, mitigation of risk, increased access to relevant information, and relative ease of investment.[245]

In addition, commodity backed securities represent an opportunity to support a cause that is consistently popular with voters: the American "family farm."[246] To the extent that socially

242. Foreign investment in the United States is at record levels. As of the last survey conducted by the United States Treasury, foreign investment in long-term securities exceeded $2.8 trillion. *See* U.S. DEP'T OF THE TREASURY, SUMMARY OF REPORT ON FOREIGN PORTFOLIO INVESTMENT IN THE UNITED STATES AS OF DEC. 31, 1997 (last visited Jan. 31, 2005), http://www.treas.gov/tic/shl94sum.html (on file with the North Carolina Law Review).

243. *See* ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., RESEARCH EMPHASIS—A COMPETITIVE AGRICULTURE SYSTEM: OVERVIEW, *at* http://www.ers.usda.gov/Emphases/Competitive/overview.htm (last updated Oct. 10, 2003) [hereinafter COMPETITIVE AGRICULTURE] (stating that the United States' share of the global agriculture market is just under twenty percent and agriculture has a high rate of productivity) (on file with the North Carolina Law Review).

244. *See supra* Part I.C (noting the information required of farmers in order to receive subsidies); *see also* FEDSTATS, *supra* note 201 (providing information on American farms, ranging from demographic to financial).

245. *See supra* Part II.B (outlining the benefits and risks of securitization). Having a single originator greatly increases the entity risk of a securitization, suggesting that multiple originator securitizations backed by a third party guarantee, such as the one urged in this Comment, are inherently less risky because they spread risk of default over a number of entities.

246. *See* AM. FARMLAND TRUST, PROTECTING OUR MOST VALUABLE RESOURCES: THE RESULTS OF A NATIONAL PUBLIC OPINION POLL 4 (2001) (citing a public opinion poll showing that eighty-one percent of respondents wish to buy food from an American farm and eighty percent know of and support federal subsidy programs that benefit

responsible investing is a concern for investors, giving struggling farmers a fair shake may be attractive.

The fact that the securities will be backed by the United States government could lend the investments an extra level of protection, similar to United States treasury bonds.[247] The increased investor confidence based on this implied "rating" could translate into a higher price for the securities.[248] Likewise, political and economic stability in the United States could make the securities attractive to investors, as would the relative ascendancy of American agriculture.[249]

The federal government could also add an extra level of benefit to investors by allowing favorable tax treatment of commodity backed securities, similar to municipal bonds.[250] By foregoing tax revenue on commodity backed securities, the securities would have more intrinsic value to investors, and the federal government could lessen its obligation to subsidize, since more capital would be drawn from the private market.

B. Alternative Models

Sponsoring an SPV is not the only way the federal government could make a foray into securitization; the federal government could opt to act as a guarantor for a private SPV.[251]

This lesser commitment could give the federal government time to set up its own SPV and allow it to take advantage of the expertise and experience of private financial intermediaries. It could also allow for smaller scale securitizations, such as on a crop-by-crop basis, until the creation of an overarching federal SPV. However, because the

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"family farms"), http://www.aftresearch.org/farmbill/docs/report-1.pdf (on file with the North Carolina Law Review).

247. United States Treasury bonds typically trade at a premium, i.e., have a lower rate of return, because investors view the guarantee that the United States government will not default on its bonds to be more trustworthy than that of other offerings. *See* BUREAU OF THE PUBLIC DEBT, FREQUENTLY ASKED QUESTIONS ABOUT TREASURY BILLS, NOTES, AND BONDS, *at* http://www.publicdebt.treas.gov/sec/secfaq.htm#secfaq1 (last updated Jan. 3, 2005) (on file with the North Carolina Law Review).

248. *See* FRANKEL, *supra* note 137, at 396–99 (noting the effects of a favorable rating for securities).

249. *See* COMPETITIVE AGRICULTURE, *supra* note 243 (stating that the United States has roughly twenty percent of the world agricultural market share).

250. *See* I.R.C. § 103(a) (West 2004) (noting the special tax-exempt status of municipal bonds).

251. *See, e.g.*, *supra* note 126 and accompanying text (noting that the secondary market in home mortgages was statutorily backed by the "full faith and credit" of the United States government).

federal government already has access to the information needed to analyze the risks of a securitization[252] and already controls a system of distribution of subsidies,[253] it may be more efficient to shift the manner of distribution internally, rather than transferring information and authority to a private financial intermediary. However, the federal government will almost certainly be obliged to solicit private consulting, and perhaps it would be cheaper to turn over administration of the SPV entirely.

CONCLUSION

If the floor price of the securitization were set at current subsidy "target" levels, the government would have less cost to cover in a securitization because of the elimination of direct payments and because it could wait until post-harvest to honor its guarantees. The floor price could be set lower in a securitization than the target price currently is for subsidies, because of the added value of the accelerated payment to producers. The exact savings of securitizing commodities would depend heavily on market conditions, but the heightened efficiency of a securitization could save the federal government billions in the short-term. In the long-term, securitization of commodities may completely obviate the need for agricultural subsidies, as the private securitization market makes inroads into agriculture similar to the mortgage market.[254] This would be the ideal situation for producers, taxpayers, and the federal government alike.

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252. *See, e.g.*, *supra* Part I.C (outlining the information required to calculate payment of subsidies under the current subsidization structure); *supra* note 187 (noting the weather risk analysis tools already available to and administered by the federal government).

253. *See supra* note 79 (noting the existence and role of the FSA, which would be an ideal agency to administer a federal securitization of commodities).

254. *See supra* notes 124–26 and accompanying text. A similar invigoration of the market in commodity-backed securitizations would be possible with government sponsorship.