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Farm Commodity Programs: A Short Primer

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Summary

The U.S. Department of Agriculture (USDA) is required, primarily by the Federal Agriculture Improvement and Reform ((FAIR) Act of 1996, to provide income support, price support, and/or supply management for approximately 20 specified agricultural commodities. Comprehensive farm legislation in 1996 was intended to usher in a new system of price and income supports for many of these commodities by accelerating the shift toward a more "market-oriented" agricultural policy and by gradually reducing financial support. However, unanticipated declines in export markets and in farm prices led Congress to enact a series of supplemental measures from 1998 through 2001 that provided additional *ad hoc* support for producers, greatly increasing the cost of commodity assistance. Continued market uncertainties, high federal spending, and the expiration, in 2002, of many provisions of the 1996 act, all make these programs the subject of intense debate in the 107th Congress.

Overview

USDA farm support programs represent the heart of U.S. farm policy, by virtue of their longevity – they have existed since the early 1930s – and their cost. Net outlays for the Commodity Credit Corporation (CCC), USDA's financing mechanism for the programs, are expected to average more than $15 billion annually between FY1996 and FY2002, with FY2000 outlays at a historical record of $32.3 billion.[1]

Standing authority for USDA-CCC programs is provided mainly by three permanent laws: the Agricultural Adjustment Act of 1938 (P.L. 75-430), the Agricultural Act of 1949 (P.L. 81-439), and the CCC Charter Act of 1948 (P.L. 80-806). However, Congress frequently alters or suspends many provisions of these laws through omnibus, multi-year farm acts, and various budget measures. The most recent omnibus law, intended to guide program operations through 2002, is the 1996 Federal Agriculture Improvement and Reform Act (P.L. 104-127). "Emergency" farm funding laws since then, notably sections

[1] The Department's Farm Service Agency (FSA) delivers commodity program benefits through a network of local ("county") offices overseen by committees of elected farmers.

of P.L. 105-277, P.L. 106-78, P.L. 106-224, and P.L. 107-25, have increased support (generally temporarily) for most major commodities.

Current law *requires* the Secretary of Agriculture to offer support for wheat, feed grains (corn, sorghum, barley, oats), cotton (upland and extra-long staple–ELS), rice, soybeans and other oilseeds (sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed), milk (dairy), peanuts, sugar, and tobacco. Most of these, plus several others (primarily wool, mohair, honey, cranberries, and apples), also have been eligible for additional *ad hoc* support under the supplemental measures that Congress enacted in 1998-2001, in response to export market losses and low farm prices.[2]

The commodities eligible for mandatory support under standing legislation accounted for approximately $68 billion, or 35%, of all cash receipts from farm marketings in 2000. Other commodities that normally receive no direct support include meats, hay, poultry, fruits, nuts, and vegetables, which together generated farm receipts estimated at $127 billion in 2000. But even producers of these items can be affected by farm policy decisions, either because such producers also raise some price-supported commodities, or because Government intervention in one farm sector can influence production and prices in another sector.

Statutorily Required Support

Policymakers have devised a variety of program methods for the CCC to assist producers; generally, each was designed to achieve one of three broad objectives:

- To ***supplement farmer incomes***. Methods include *production flexibility contract payments* for grains and cotton, and *marketing loans* and *loan deficiency payments* for grains, cotton, and oilseeds (recent legislation has provided *ad hoc* direct payments and/or loan benefits for wool, mohair, oilseeds, tobacco, honey, milk, peanuts, apples, and cranberries);

- To ***manage supplies***. *Marketing quotas/acreage allotments*, for tobacco, and *poundage/marketing quotas*, for peanuts are used to restrict output;

- To ***support farm prices***. Methods include *nonrecourse marketing loans* for grains, cotton, sugar, peanuts, tobacco, and oilseeds, and *commodity purchases* for milk (recent legislation has provided *ad hoc* loans for mohair and honey and direct purchases of various fruits and vegetables).

The supports employed, levels of aid, and impacts on taxpayers, consumers, and other producers, differ among the commodities. Some commodities are supported by only one method; others receive their support through a combination of program tools.

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[2] Most of this *ad hoc* support has been for one or two crop or marketing years only, and did not permanently alter standing legislation (e.g., the 1996 farm law). Most of these measures also provided separate funding for disaster-related losses. See CRS Report RL30794, *Farm Economic Relief and Policy Issues in the 106th Congress: A Retrospective*, and CRS Report RL31905, *Emergency Spending for Agriculture: A Brief History of Congressional Action, FY1989-2001.*

Wheat, Feed Grains, Upland Cotton, and Rice. These programs were overhauled in 1996. No longer would payments be tied to market prices ("target price deficiency payments"), to the planting of a specific crop, or to annual cropland diversion requirements. Instead, most eligible producers (those with acreage enrolled in the old grains and cotton annual programs) signed *production flexibility contracts* entitling them to fixed, but generally declining, annual payments for 7 years. These payments, totaling nearly $36 billion nationally through 2002, are based on each participant's established acreage and yield (per-acre output) under the old programs. However, participants can plant almost any combination of crops on contract acreage. The only other restrictions are that contract land must be used for agricultural purposes, generally fruits and vegetables cannot be produced on such land, and conservation rules must be followed.

Those with the contracts also are eligible for *nonrecourse marketing assistance loans*, and *loan deficiency payments*. To qualify, a farmer pledges the stored crop as collateral. Loan rates generally are set at 85% of a moving average of past market prices; there are caps and (for some) floors on these rates. For 2001 crops, USDA announced national average loan rates of $2.58 per bushel (bu.) for wheat, $1.89 per bu. for corn, 51.92 cents per pound (lb.) for upland cotton, and $6.50 per 100 pounds (cwt.) for rice.

Nonrecourse loans must be repaid with interest within 9 months (10 months for cotton) or else the producer forfeits the pledged commodity to the government, which has "no recourse" other than to accept it in lieu of money. However, two provisions are intended to make forfeitures – and buildup of CCC-owned surpluses – less frequent than under past policy. First, the "marketing loan" provision enables the farmer to repay the loan at a USDA-calculated rate that is intended to approximate market prices. If that repayment rate is below the original USDA loan rate, the farmer captures the difference as a subsidy (marketing loan gain). Loan deficiency payments (equal to marketing loan gains) also are made to eligible producers choosing *not* to take out a crop loan. Second, the 1996 law instructs USDA to set loan rates at levels that will minimize forfeitures.

Supplemental legislation (P.L. 105-277) effectively increased payments to contract holders by approximately 50% in 1998. Later, P.L. 106-78, P.L. 106-224, and P.L. 107-25) roughly doubled the payments in 1999, 2000, and 2001. These extra *market loss assistance payments* were exempted from regular annual payment limits (see page 5). P.L. 106-224 also extended loan deficiency payment eligibility – for the 2000 crop year only – to anyone who grew a contract commodity, not just contract holders. (See CRS Report RS20271, *Grains, Cotton, and Oilseeds: Federal Commodity Support*.)

Soybeans, Other Oilseeds, and ELS Cotton. Producers of these commodities are not eligible for the 7-year contracts, but can receive *nonrecourse marketing assistance loans* and *loan deficiency payments*. USDA set average 2001 rates at $5.26 per bu. for soybeans, $9.30 per cwt. for most other oilseeds, and about 80 cents per lb. for ELS cotton. The "emergency" farm bills also provided supplemental *direct payments* to soybean and other oilseeds producers, sharing a total of $475 million for 1999, $500 million for 2000, and $424 million for 2001.

Tobacco and Peanuts. These commodities are supported through a combination of *nonrecourse loans* and *supply controls*. The tobacco program, intended to be operated at no net government cost, employs the most aggressive supply control: all sales of major tobacco types are strictly limited to farms with *marketing quotas*. Under the peanut

program, *marketing quotas* (formally called *poundage quotas*) limit the quantity of peanuts that can be marketed for domestic edible use; such peanuts are eligible for a higher loan rate than above-quota ("additional") peanuts, which must be crushed for oil or feed, or exported. Each year, a nationally-set quota is established and then allocated among eligible producers. The loan rate for quota peanuts is set by law at $610 per ton; by contrast, the 2001 rate for above-quota peanuts is $132 per ton. Because the supply control features of the peanut and tobacco programs keep market prices higher than they would otherwise be, consumers rather than taxpayers generally bear most program costs. However, three of the supplemental measures (P.L. 106-78, P.L. 106-224, and P.L. 107-25) are to provide special *direct payments* totaling, over 3 years, about $143 million for peanuts and $797 million for tobacco. (See CRS Issue Brief IB95118, *Peanuts: Policy Issues*; and CRS Report 95-129, *Tobacco Price Support: An Overview of the Program.*)

Sugar. Support no longer includes the supply control mechanism of the pre-1996 program but still is supposed to operate, in effect, at no net cost to the Government. Until 2000, price support was provided through a nonrecourse/recourse loan mechanism, combined with restrictions on sugar imports. Only *recourse loans* (which must be repaid in cash, with interest) were available to sugar processors whenever annual imports were below 1.5 million tons. Whenever imports exceeded 1.5 million tons, *nonrecourse loans* would be triggered. However, the FY2001 USDA appropriation (P.L. 106-387) now requires that all sugar loans be nonrecourse, regardless of import levels. Loan rates are 18 cents per lb. for raw cane sugar and 22.9 cents per lb. for refined beet sugar. (See CRS Issue Brief IB95117, *Sugar Policy Issues*.)

Milk. Milk price support is provided through surplus *commodity purchases* from processors. The CCC buys all bulk quantities of cheese, butter, and nonfat dry milk that dairy processors are unable to sell on the private market for at least the prices offered by the CCC. Per-pound prices are set so that processors will in turn pay farmers a price for their milk that reflects at least the federally mandated support price, currently $9.90 per cwt. The program was to be replaced after 1999 by *recourse loans* for processors, but USDA appropriation measures have extended the old program through calendar 2001. In addition, two of the supplemental aid laws authorized *direct payments* to dairy farmers totaling nearly $600 million. (See CRS Issue Brief IB97011, *Dairy Policy Issues*.)

Other Commodities. Several crops and animal products that either are not typically supported through the CCC, or had lost their "mandatory" support after the 1996 farm law, were made temporarily eligible for support under one or more of the supplemental farm laws. The 2000 **honey** crop is eligible for *nonrecourse marketing assistance loans* (set at 65 cents per lb.) as well as *loan deficiency payments*. **Wool** and **mohair** are eligible for *direct payments* of 20 cents per lb. for 2000 marketings; the rates for 1999 marketings were 20 cents for wool and 40 cents for mohair. P.L. 107-25 authorized more payments for 2001. In addition, mohair produced before or during FY2000 was eligible for *recourse loans* set at $2 per lb. (Congress earlier had terminated support for honey, wool, and mohair.) **Apple** and **cranberry** producers were to receive one-time *direct payments* totaling $100 million and $20 million, respectively, to cover past crop market losses. USDA was directed by P.L. 106-224 to *purchase* $200 million in **various fruits and vegetables** experiencing low 1998 and 1999 crop year prices. And, P.L. 107-25 directs USDA to distribute $133.4 million in block grants among states, to be used for supporting **specialty crops** (which include fruits and vegetables).

USDA Discretionary Support

In addition to the explicitly-required forms of support described above, federal law has long *permitted* the Secretary to offer, at his or her discretion, support for virtually any farm commodity. Recent examples of such support announced by the Secretary include *direct payments* of up to $10 per head for **hogs** in 1999, and of up to $8 per head for **lambs** (under a 3-year lamb meat adjustment assistance program). In 2000, the Secretary decided to make *direct purchases* of surplus **sugar**, and also to transfer title to 277,349 short tons of CCC-owned sugar to farmers who agreed to destroy nearly 102,000 acres of planted sugar beets. (Another such sugar program was set for fall 2001.) Funds for these various activities can come from a number of sources, including CCC and Section 32.[3]

Payment and Loan Limitations

Most farm subsidies have been tied to commodity units; therefore, higher output means higher potential benefits, up to certain limits. The law sets an annual ceiling for production flexibility contract payments at $40,000 for each person, who must be actively engaged in farming. The law sets a separate annual ceiling for gains from marketing loans, at $75,000 per person; thus a person potentially could receive up to $115,000 per farm. However, because an individual can receive *half*-payments on two additional farms, the effective annual cap on total combined payments actually has been $230,000 per person. Because limits apply to individuals rather than farm units, a single farm with multiple owners/operators might receive much more than the above amounts. Also, there is no per-person monetary limit on outstanding CCC loans or on surplus purchases.

As noted, the special market loss payments provided by the supplemental farm laws are not subject to any payment limitations. Also, the loan payment cap threatened to undermine use of marketing loans for recent crops by encouraging farmers to default on their nonrecourse loans. Consequently, the limit on loan gains for 1999, 2000, and 2001 crops was doubled to $150,000 per person by P.L. 106-78, P.L. 106-387, and P.L. 107-25.

Policy Discussion

When the commodity programs were first authorized in the early 1930s, most of the Nation's 6 million farms were diversified and small (by today's standards). There was a perceived need to address the severe economic problems then faced by this large segment of society, where about 25% of the U.S. population then resided. Moreover, it was argued, stabilizing the agricultural sector – through guaranteed minimum farm prices, income payments to producers, and/or various supply management techniques – also helped to ensure an abundant supply of food and fiber at reasonable prices in the future.

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[3] Section 32 is a permanent appropriation that earmarks the equivalent of 30% of annual customs receipts to support the farm sector through a variety of activities. Most of this appropriation (now about $5.7 billion per year) is simply transferred directly to USDA's child nutrition account to fund school feeding and other programs. However, Section 32 also provides USDA with a source of discretionary funds of up to $300 million annually, which it uses for "emergency removals" of surplus agricultural commodities, disaster relief, or other unanticipated needs. See CRS Report RS20235, *Farm and Food Support Under USDA's Section 32 Program.*

Since then, farming has undergone significant change. Most commercial agriculture is now confined to fewer, larger, and more specialized operations. In 1997, about 157,000 large farms, with annual agricultural sales averaging about $900,000, accounted for 8% of all U.S. farms but 72% of all farm sales. Most of the nation's 2 million farms are primarily part-time, where operators rely on off-farm earnings for most of their income. Farm residents now account for less than 2% of the general U.S. population.

Also, the economic health of the farm sector has become increasingly tied to overseas markets, where there are not only more sales opportunities for U.S. farmers but also stiff competition from foreign producers – who themselves may be protected by subsidies or import barriers. Critics have long argued that U.S. commodity policies are outdated and may even be detrimental to the needs of modern agriculture, and of society in general. While the programs have retained features dating to the 1930s, they also have evolved – in response both to the changes occurring in agriculture and the economy, and to fiscal and political pressures. A major point of contention has been whether they have evolved quickly enough, or in the most appropriate ways.

Congress and the Administration have sought for many decades to steer price and income support programs onto a more "market-oriented" course, so that producers would look to the private market rather than the Government for economic rewards from production agriculture. A succession of farm bills, particularly since the 1970s, moved farm policy in this direction, mainly through incremental changes in existing programs. The 1996 farm law, written at a time of high farm prices and expanding exports, was aimed at accelerating the programs' market orientation.

CCC net outlays averaged $15 billion yearly during the 1980s, peaking at $26 billion in fiscal year 1986. By the 1990s, improved market conditions, plus program reductions mandated by various farm and omnibus budget laws, had lowered CCC outlays to an average of nearly $10 billion yearly between fiscal years 1990 and 1995. The 1996 farm law anticipated even lower spending, at an average of less than $6 billion yearly.

However, unanticipated declines in export markets and in farm prices not only drove up the cost of the programs already authorized by the 1996 farm law (primarily marketing loans and loan deficiency payments), but also led Congress to enact, between 1998 and 2001, more aid. Approximately $30 billion in emergency farm and related assistance has been approved, of which some $22 billion was in response to falling commodity prices (the rest was natural disaster aid). For *calendar* 2000, direct farm payments reached a total of $24 billion – a figure representing over one-half of net farm income for the year. CCC net outlays for *all* farm-related programs and activities reached a record $32.3 billion in *fiscal* year 2000 and are estimated at $20.5 billion in FY2001.

Such record-high subsidies have helped the farm economy as a whole remain in relatively strong financial condition. However, most policymakers and farm groups would prefer a more reliable method for supporting farm income than ad hoc laws; some are pushing for policy changes that will automatically release funding when farm income is not sufficient to maintain viability. Allocating resources for such changes, and resolving ideological differences over the best method of assisting farmers, are likely to be difficult. These issues are at the heart of the debate over current programs, most of which expire in 2002.