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Farm "Counter-Cyclical Assistance"

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Summary

Congress is now considering reauthorization of major farm income and commodity price support programs that expire after crop year 2002. Many agricultural interests expect that a new "counter-cyclical assistance" program will be an integral component of future farm policy. The intent of counter-cyclical assistance is to provide more government support when farm prices and/or incomes decline, and less support when they improve. Farmers already receive federal aid that is counter-cyclical. Although differing in detail, omnibus farm bills passed in October 2001 by the full House and in February 2002 by the Senate Agriculture Committee create additional aid as a long-term and guaranteed source of counter-cyclical support for grains, cotton and oilseeds. This aid would be in the form of deficiency payments tied to target prices for each crop.

Background

Farming often is characterized as a "cyclical" business with exaggerated price swings that are destabilizing. Farmers respond to high prices by boosting output. However, when prices drop, farmers are not quick to cut back production. They are more likely to operate at a loss and draw down resources. Contributing to the unstable nature of the farm economy are the weather, export demand, currency exchange rate fluctuations, and the farm support and export subsidy programs of foreign competitors.

Typically, farmers do not view the eventual self-correcting character of commodity prices and production with the same equanimity as economists. In fact, U.S. producers of the major crops have asked for and received federal intervention – including various forms of counter-cyclical assistance – to support their commodity prices and incomes for nearly the past 70 years.

Prior to the current farm law, the Federal Agriculture Improvement and Reform Act of 1996 (P.L. 104-127), a prominent form of counter-cyclical aid was deficiency payments linked to target prices. Congress specified, for each major crop, an annual per-unit target price (e.g., $4 per bushel for wheat). If, as often occurred, the market price was below the target price, eligible producers received a deficiency payment to make up the difference.

Provisions of Current Law

Under Title I of the 1996 Act fixed production flexibility contract (PFC) payments replaced target price deficiency payments. These payments began at about $5.6 billion in 1996 and gradually have declined, to about $4 billion in 2002, for a 7-year total of about $36 billion. The PFC payments are not linked to either current production or prices. By design, lawmakers intended that these fixed payments, along with the freedom to make unconstrained planting decisions, would cause the marketplace rather than subsidies to guide farmers' production choices.

However, the 1996 law did continue another form of counter-cyclical support: marketing assistance loans. Producers can pledge their stored grain, cotton, or oilseeds as collateral for a U.S. Department of Agriculture (USDA) nonrecourse commodity loan after harvest. These loans are based on a per-unit rate (i.e., $2.58 per bushel for wheat).

In earlier years, these nonrecourse loans were set higher than market prices in order to support farm incomes, and farmers forfeited the commodities pledged as collateral at the end of the loan term (about 9 months). Under the more recent design, farmers can repay the nonrecourse "marketing assistance loans" at less than the original loan rate when market prices are lower than that loan rate. The difference between the USDA loan rate and the lower repayment rate (times the number of bushels under loan) constitutes the federal subsidy. In addition, those producers who do not take out USDA commodity loans can instead receive the equivalent subsidy as a direct payment, called a "loan deficiency payment" (LDP). The federal subsidy (either a loan gain or LDP) increases as market prices drop below the loan rate, and the subsidy diminishes as prices rise – thus, the "counter-cyclical" nature of the marketing loan program.

When the 1996 farm bill was passed, commodity prices were relatively high, and policymakers widely anticipated that the PFC payments, when combined with whatever was earned from the market, would provide sufficient income to producers. Marketing loans were set at relatively low rates so that they only would be needed as a safety net if prices declined relatively steeply. However, by the late 1990s, major commodity prices declined steeply, and did not recover to generally profitable levels. As a result, marketing loan benefits, close to zero in FY1996 and FY1997, jumped to over $8 billion by FY2000 and are estimated at $6.3 billion for FY2001.[1]

Congress determined that the "safety net" provided by the 1996 FAIR Act (i.e., marketing assistance loans and fixed PFC payments) was inadequate, and supplemented the benefits with additional, emergency "market loss payments." These payments, mainly to PFC enrollees, added about $3 billion in FY1999, $11 billion in FY2000, and $5.5 billion in FY2001 to program costs. These supplemental payments also can be characterized as counter-cyclical – even though they are *ad hoc* and not "programmed" into standing law – because they are being made (according to the sponsors) in response to low prices and incomes.

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[1] Marketing loan benefit level data are from CCC, Commodity Estimates Book, April 2001.

New Counter-Cyclical Proposals

Under the separate farm bills passed on October 5, 2001, by the House and on February 13, 2002, by the Senate, new counter-cyclical measures would be built into standing law. Thus, Congress presumably would no longer have to debate and enact periodic emergency *ad hoc* assistance.

Specifically, the both versions of the farm bill (H.R. 2646, which next must clear a House-Senate conference) provide new long-term counter-cyclical support for grains and cotton, by restoring target prices and deficiency payments, the type of program terminated by the 1996 Act. In addition, both bills would maintain marketing assistance loans and loan deficiency payments as they now function, with changes in some loan rates (generally higher in the Senate version; see Table 1). What are now called fixed annual PFC payments would be replaced with fixed, decoupled payments to farmers who sign new 10-year "agreements" (House version), or 5-year "contracts" (Senate version). Rates differ between the bills.

Both bills would bring soybeans and the minor oilseeds (e.g., sunflowers, etc.) fully under the support program rules that apply to grains and cotton. In a major departure from the past, both also would support peanuts like soybeans instead of the traditional system of peanut marketing quotas and nonrecourse price support loans.

Under the 10-year House bill, fixed payments and target price deficiency payments would be paid on 85% of each farm's base production (base acres times base yield of each commodity). A farmer could choose, as base production, either the acreage used for PFC payments, or average acres planted to eligible crops from 1998 through 2001. Yields effectively are the 1981-85 averages. Under the 5-year Senate bill, fixed payments and target price deficiency payments would be paid on 100% of each farm's base production. As in the House bill, the farmer could choose either PFC acreage or 1998-2001 average acres as the base. However, the Senate version permits farmers to update their per-acre yields to reflect the annual averages for 1998-2001.

The deficiency payment rate would be calculated under both bills as the difference between the target price and the lower average season market price (but not to exceed the difference between the target price and the sum of the loan rate and fixed payment). However, the bills have different target prices (see Table 1).

Milk support would continue under both bills through government purchases of nonfat dry milk, butter, and cheese. However, the Senate bill has an added feature of counter-cyclical target price deficiency payments. Under the proposal, dairy farmers in 12 Northeastern states would receive a federal payment whenever the minimum monthly market price for farm milk used for fluid consumption falls below $16.94 per hundredweight (cwt.). The payment received by Northeast farmers would be 45% of the difference between the $16.94 target price and the market price. Milk producers in all other states also would be entitled to a federal payment whenever the average farm milk price for a calendar quarter is below the average price for the same quarter during the previous 5 years. The payment rate would be 40% of the difference between the average historical price and the lower market price. (See *Dairy Farmer Counter-Cyclical Assistance* in the CRS electronic briefing book on *Agriculture Policy and the Farm Bill*.)

Table 1. House and Senate Versions of H.R. 2646: Loan Rates, Direct Payments, and Target Prices

Crop	Loan/Support Rates		Fixed, Decoupled (Direct) Payments		Counter-Cyclical Target Prices[a]	
	House[b]	Senate	House	Senate[c] 2002/03, 2004/05, 2006	House	Senat e
Wheat, $/bu	2.58	2.9960	0.53	0.45, 0.225, 0.113	4.04	3.4460
Corn, $/bu	1.89	2.0772	0.30	0.27, 0.135, 0.068	2.78	2.3472
Sorghum, $/bu	1.89	2.0772	0.36	0.31/0.27, 0.135, 0.068	2.64	2.3472
Barley, $/bu	1.65	1.9973	0.25	0.20, 0.10, 0.05	2.39	2.1973
Oats, $/bu	1.21	1.4980	0.025	0.05, 0.025, 0.013	1.47	1.5480
Cotton, $/lb	0.5192	0.5493	0.0667	0.13, 0.065, 0.0325	0.736	0.6739
Rice, $/cwt	6.50	6.4914	2.35	2.45, 2.40, 2.40	10.82	9.2914
Soybeans, $/bu	4.92	5.1931	0.42	0.55, 0.275, 0.138	5.86	5.7431
Minor oilseeds,$/lb	0.087	0.095	0.0070	0.01, 0.005, 0.0025	0.1036	0.1049
Peanuts, $/ton (cts/lb)	350[d] (17.5)	400 (20)	36 (1.8)	all years, 36 (1.8)	480 (24)	520 (26)

[a] *Payment bases differ between the bills.*
[b] *Loan rates are maximum allowable levels.*
[c] *Reflects payment rates that begin at higher levels in 2002 and decline by 2006.*
d *This is support level for quota peanuts; the support level for nonquota peanuts is $174/ton ($0.087/lb).*

Nearly all of the numerous farm and commodity organizations that testified before the Agriculture Committees in 2001 requested that additional counter-cyclical support be developed as a supplement to the current marketing assistance loans and fixed annual payments, which the House and Senate bills do. Whereas both bills tie the availability of counter-cyclical assistance to target prices for specified commodities, other designs also were examined. For example:

- One plan would trigger payments in a state whenever state (as opposed to national) gross cash receipts for any of eight program or oilseed crops are forecast for the year to be less than 94% of that state's annual average cash receipts for the crop during 1996-1999. Cash receipts would be defined as the national average price times state-level production. Those who produced the crop during 1998-2000 would be eligible for a share of total payments (American Farm Bureau Federation).

- Another would establish a "national target income" for each major crop: that is, the national average annual market value of the crop during 1996-2000, plus the annual average of any marketing loan benefits and market loss assistance payments made during those years. A further adjustment would be made to account for yield increases since then. Those who produced that crop during 1996-2000 would be eligible for a share of total payments whenever returns (defined as the crop's U.S. production times the average price for the first 3 months of the marketing year) are below the national target income for the crop (National Corn Growers Association).

Selected Issues

Cost

The Congressional Budget Office (CBO) estimated the commodity support provisions of the House version of H.R. 2646 at nearly $119 billion over 10 years (FY2002-2011). This is approximately $49 billion more than the baseline policy of simply extending current programs into the future. About $37 billion of the total 10-year cost was attributed to the new counter-cyclical payments.

CBO estimated the commodity support provisions of the Senate bill at about $110 billion over 10 years. This is approximately $40 billion more than the baseline. About $19 billion of the total 10-year cost is attributed to the new counter-cyclical payments. (Because the Senate bill would set crop loan rates higher than the House, more of the potential counter-cyclical aid would be in the form of marketing loan benefits.) However, the Senate bill is only a 5-year authorization. During that period (FY2002-2006), the commodity support provisions would cost about $26 billion above baseline, of which over $5 billion represents the counter-cyclical payments. (CBO assumes that under the Senate bill, these payments will not result in substantial outlays until FY2005.)

The overall additional estimated cost of both farm bills (commodity plus other provisions) is apparently still within the $73.5 billion limit permitted under the 10-year budget resolution (H.Con.Res. 83), approved in spring 2001. Still, annual commodity program costs would average a projected $12 billion under the House bill and more than $11 billion under the Senate bill. By comparison, from FY1996 through FY2001, annual spending on commodity support programs, including emergency assistance, averaged $7.3 billion. (For details, see *Agriculture and the Budget* in the CRS electronic briefing book on *Agriculture Policy and the Farm Bill*.)

International Trade Obligations

The 1994 Uruguay Round Agreement on Agriculture (URAA) obligates countries to discipline their agricultural subsidy programs and reduce import barriers in order to promote more open trade. Under the URAA, the United States is committed to subsidies of no more than $19.1 billion per year under domestic farm policies with the most potential to distort production and trade.

The URAA contains detailed rules for countries on how to determine which of their programs must be counted toward their assigned subsidy limits (e.g., $19.1 billion for the United States). Generally, however, programs that are tied to current prices or current production must be counted (these are called “amber box” policies). Thus, marketing loan gains, which rise when crop prices decline and vice versa, are “amber” and must be counted (but only if their value, along with other subsidies, exceeds 5% of the value of annual production of that crop). Like marketing loan gains, the proposed target price deficiency payments in H.R. 2646 would be triggered by current market prices, so they likely would be considered amber box.

Subsidies that are not linked to prices or production, and/or meet other specified criteria, might be exempted as “green box” policies. The United States has classified its PFC payments as “green” because they are made without regard to prices or current

production. It is anticipated the fixed, decoupled payments in H.R. 2646 would be green box, although it might be argued that permitting producers to update base acres (and, in the Senate version, also crop yields) for payment purposes might make them vulnerable to challenge as amber box. (See CRS Report RS20840, *Farm Program Spending: What's Permitted Under the Uruguay Round Agreements*.)

Some groups have argued that their own counter-cyclical policies could be designed in a way that they would not have to be counted toward the $19.1 billion limit. For example, if payments to farmers were triggered by low income (as measured by gross receipts for one or more commodities) rather than by low prices, they would be exempt, it has been argued. Others dispute this assertion, noting that it is usually low prices that cause low income. So, they conclude, if counter-cyclical payments, when added to other "amber" spending such as marketing loan benefits, caused U.S. spending to exceed $19.1 billion, the United States could be in violation of its world trade commitments.

Differing language in the House and Senate bills is intended to provide a "circuit breaker" to curtail farm spending in order to stay at or below the $19.1 billion limit. One issue is whether any such "circuit breaker" would be feasible. U.S. and all other countries' reports to the WTO on farm subsidies are retrospective. Making benefit calculations far enough in advance to flag possible "overspending" would be difficult at best, given the highly speculative (and often incorrect) nature of forecasting future crop production, prices, and other critical data. Questions also arise about the administrative, economic, and political implications of changing (i.e., reducing) benefits after they are announced and farmers make their planting decisions based upon these announcements.

Benefit Distribution

The new counter-cyclical aid in the House and Senate bills focuses on the major crops – grains, cotton, and oilseeds (and, in the Senate bill, on milk). These generally are the most widely produced, but that still would leave much of U.S. agriculture ineligible for such payments, raising questions of equity among commodities, and of the potential for distorting production toward items that might receive more support. On the other hand, extending such assistance to more commodities, such as fruits, vegetables, or livestock, also could increase federal costs, or else mean reduced assistance for grains, cotton, and oilseeds. Not all commodity groups are seeking such aid, however. For example, the National Cattlemen's Beef Association is among those that remain opposed to most forms of direct assistance, counter-cyclical or otherwise. And, the United Fresh Fruit and Vegetable Association argued against any subsidies that would insulate fruit or vegetable producers from market signals or would sustain or encourage production.

Another issue is whether a new counter-cyclical program should perpetuate past patterns of tying aid to output rather than economic need. Federal farm programs, including PFC payments, marketing loans and the *ad hoc* "market loss payments," have been based on either past or current production by individual farmers, meaning that larger payments have trended toward larger operations – which do not or should not need them, critics argue. They add that if Congress intends to help producers in economic distress, then such recipients should have to document their need. Others counter that farm programs are not "welfare" but rather part of a larger policy to ensure that U.S. agriculture remains competitive in the global economy (an assertion that critics challenge).