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Payment Limits for Farm Commodity Programs: Issues and Proposals

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Summary

Payment limits restrict the dollar amount of farm program payments per person. Limits on commodity program payments have been imposed since 1970. The 2002 farm bill retains the former limits and adds limits for the new counter-cyclical program. It continues to permit commodity certificates to be used to avoid marketing loan limits. Federal budget constraints and public awareness of large payments reaching a small number of very large farms have focused congressional attention on payment limits.

In the108th Congress, Senator Grassley introduced S. 667 to reduce the maximum amount of direct and counter-cyclical payments that producers can receive, and to count commodity certificates toward the marketing loan limit. Senate budget resolutions for both FY2005 and FY2004 also contained nonbinding amendments by Senator Grassley to reduce agriculture spending, presumably through savings from payment limits.

Converting the dollar limits into acreages for each crop makes it easier to see how certain farms might be affected. Reducing payment limits likely would affect more cotton and rice farms than feed grain and oilseed farms . This report will be updated as events warrant.

Background on Payment Limits

Payment limits restrict the dollar amount of farm program payments a "person" can receive. They have been prescribed in the law since the Agricultural Act of 1970 (P.L. 91-524) and continue in the 2002 farm bill (the Farm Security and Rural Investment Act, P.L. 107-171, Sec. 1603). The term "person" is defined more broadly than an individual, and can include certain kinds of corporations, partnerships, and trusts.

The issue was controversial when the 2002 farm bill was written, and the policy debate continues into the 109th Congress. The debate is more about farm size and the purpose of farm programs, rather than the financial needs of recipients, since farmers do not need to demonstrate financial hardship to be eligible. Limits are intended to reduce program expenditures and to address perceived inequities in payment distributions.

The effect of payment limits varies greatly across individuals and regions. Geographically, the South and West tend to have more large farms than the Upper Midwest or Northeast. By commodity, cotton and rice farms are affected more often because the subsidy per acre is relatively higher. Cotton and rice farms are also the largest users of commodity certificates (which are not limited).

Review of Payments Subject to Limits

Under the 2002 farm bill, producers generally receive three types of commodity payments that are subject to limits: direct payments, counter-cyclical payments, and marketing loan payments. Direct and counter-cyclical payments depend on a farm's historical base acreage and yields. The marketing loan program makes payments based on actual production. For more background, see CRS Report RS21779, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*.

With respect to payment limits, direct and counter-cyclical payments are relatively straightforward since they are direct transfers made in cash. Marketing loans, however, are more complicated because limits do not apply to all marketing loan mechanisms.

The marketing loan program has four mechanisms to provide benefits when market prices are below loan rates (see CRS Report RS21604, *Marketing Loans, Loan Deficiency Payments, and Commodity Certificates*).

Subject to limits:
- loan deficiency payment (LDP) — a direct payment instead of a loan,
- marketing loan gain (MLG) — repaying a loan at a lower market price.

Not subject to limits:
- "commodity certificates" — purchased at the posted county price to repay the loan; similar to an MLG but not counted toward payment limits (P.L. 106-78, Sec. 812, exempted commodity certificates from payment limits),
- forfeiting the collateral (commodity) and keeping cash from the loan.

Other farm bill programs also have payment limits. These include the Milk Income Loss Contract (MILC, 2.4 million pounds of milk annually), the Conservation Reserve Program ($50,000) and the Environmental Quality Improvement Program ($30,000).

Current Payment Limits

The 2002 farm bill retains annual payment limits, adds limits for the new counter-cyclical program, and incorporates newly eligible commodities. It also creates an income test that prohibits payments to persons or entities with adjusted gross income (AGI) exceeding $2.5 million (unless 75% or more comes from farming). **Table 1** shows the limits under the 1996 farm bill, the 2002 farm bill, and S. 667 in the 108th Congress.

The annual limit per person is $40,000 for direct payments, $65,000 for counter-cyclical payments, and $75,000 for marketing loan gains and loan deficiency payments. These amounts add to $180,000, but can be doubled to $360,000 under rules described in the next paragraph. However, because commodity certificates and forfeiture are not subject to limits, the limit on MLGs and LDPs simply becomes the point at which a farmer shifts to commodity certificates, making the marketing loan program unlimited.

The 2002 farm bill preserves two ways to double the payment limits. One is the "three entity rule," allowing one person to receive payments on up to three entities, with second and third entities eligible for one-half of the limits. The other is the "spouse rule," allowing a husband and wife to be treated as separate persons to double a farm's payment limit. Only one of the two mechanisms can be used to double the limit.

Although payments for most qualifying commodities are combined toward a single limit, separate limits apply to peanuts, wool, mohair and honey.[1]

Table 1. Payment Limits on Farm Commodity Programs

<table>
<tr><th></th><th>1996 Farm Bill
P.L. 104-127</th><th>2002 Farm Bill
P.L. 107-171</th><th>108th Congress
S. 667</th></tr>
<tr><td colspan="4">Direct and Counter-Cyclical Payments</td></tr>
<tr><td>(a) Direct Payments</td><td>$40,000 *</td><td>$40,000</td><td>$20,000</td></tr>
<tr><td>(b) Counter-Cyclical Payments</td><td>N/A</td><td>$65,000</td><td>$30,000</td></tr>
<tr><td>Doubling under Three Entity and Spouse Allowance</td><td>$40,000 *</td><td>$105,000</td><td>$50,000</td></tr>
<tr><td>Direct and Counter-cyclical</td><td>$80,000 *</td><td>$210,000</td><td>$100,000</td></tr>
<tr><td colspan="4">(c) Marketing Loan Payments</td></tr>
<tr><td>(1) Marketing Loan Gains and
(2) Loan Deficiency Payments</td><td>$75,000 *</td><td>$75,000</td><td rowspan="3">$87,500</td></tr>
<tr><td>(3) Commodity Certificates</td><td>No limit **</td><td>No limit</td></tr>
<tr><td>(4) Loan Forfeiture Gains</td><td>No limit</td><td>No limit</td></tr>
<tr><td>Doubling Under Three Entity and Spouse Allowance</td><td>$75,000 *</td><td>$75,000</td><td>$87,500</td></tr>
<tr><td>Marketing Loan Payments</td><td>$150,000 *</td><td>$150,000</td><td>$175,000</td></tr>
<tr><td>Practical Limit on Marketing Loan Payments</td><td>No limit</td><td>No limit</td><td>$175,000</td></tr>
<tr><td colspan="4">Sum of Direct, Counter-Cyclical, and Marketing Loan Payments</td></tr>
<tr><td>Total, Excluding Commodity Certificates or Loan Forfeiture</td><td>$230,000 *</td><td>$360,000</td><td>$275,000</td></tr>
<tr><td>Practical Limit, Accounting for All Payments Above</td><td>No limit</td><td>No limit</td><td>$275,000</td></tr>
</table>

Source: CRS.
Notes: Payments for most qualifying commodities are combined toward a single limit. However, separate payment limits apply to peanuts, wool, mohair, and honey in the 2002 farm bill and S. 667.
* Emergency farm assistance doubled limits under the 2002 farm bill for direct payments in 2000-2001, and for marketing loans in 1999 to 2001 (P.L. 106-78, Sec. 813; P.L. 106-387, Sec. 837; P.L. 107-25, Sec. 10).
** P.L. 106-78, Sec. 812, exempted commodity certificates used to repay loans from payment limits.

[1] See also the USDA fact sheet [http://www.fsa.usda.gov/pas/publications/facts/payelig03.pdf].

Policy Issues In Congress

Supporters of payment limits use both economic and political arguments. Economically, they contend that large or unlimited payments benefit large farms, facilitate consolidation of farms into larger units, raise the price of land, and put smaller, family-sized farming operations at a competitive disadvantage. They say that smaller limits would reduce financial incentives for farms to expand, and facilitate small and beginning farmers in buying and renting land. Politically, they believe that large payments to large farms undermines public support for farm subsidies and is costly to the federal budget.

Critics of payment limits counter that all farms are in need of support, especially when market prices decline, and that larger farms should not be penalized for the economies of size and efficiencies they have achieved. They say that such payments help U.S. agriculture compete in global markets and that income testing is at odds with federal farm policies directed toward improving U.S. agriculture and its competitiveness.

In August 2003, the Payment Limits Commission (created by the 2002 farm bill) provided a detailed report to Congress. The commission was charged to study impacts on the agricultural sector from tighter limits. The commission's ultimate recommendation was that policy makers should wait until the next farm bill before making any changes.[2]

In the 108th Congress, Senator Grassley introduced S. 667 to reduce the maximum amount of direct and counter-cyclical payments that producers can receive, and to count commodity certificates toward the marketing loan limit. The Senate budget resolutions for both FY2005 and FY2004 also contained nonbinding amendments by Senator Grassley to reduce agriculture spending, presumably through payment limitations.

S. 667 in the 108th Congress. On March 19, 2003, Senator Grassley introduced a bill that would reduce payment limits on direct, counter-cyclical, and marketing loan payments to a total of $275,000, and count commodity certificates and loan forfeiture toward marketing loan limits. The statutory limit (before doubling) on direct payments would decrease from $40,000 to $20,000; and the limit on counter-cyclical payments would decrease from $65,000 to $30,000. While the stated limit on the marketing loan program would rise slightly from $75,000 to $87,500, the effective limit is reduced because commodity certificates and loan forfeiture would be counted toward the limit. This is a key feature because, as a practical matter, marketing loan payments are not limited under the 2002 farm bill. When MLGs and LDPs hit the limit, producers can shift to commodity certificates without limit.

Tighter limits were proposed in the Senate-passed version of the 2002 farm bill (S. 1731, 107th Congress) by Senators Dorgan and Grassley, but those limits were not accepted by the conference committee. That bill would have limited direct and counter-cyclical payments to a combined $75,000, allowed only a $50,000 spouse benefit, replaced the three-entity rule with direct attribution, limited the marketing loan program to $150,000, and counted commodity certificates and forfeiture in the limit. Thus, the total limit would have been $275,000, but with slightly different limits for each payment

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[2] USDA, *Report of the Commission on the Application of Payment Limitations for Agriculture*, August 2003, at [http://www.usda.gov/oce/oce/payments/payment-commission.htm].

and less generous doubling rules than S. 667. In March 2003, CBO estimated such provisions would save $156 million the first year, and $883 million over five years.

S. 667 would establish a new rule allowing a person with an interest in only a single farming operation to double the payment limits without needing to use the three-entity or spouse rules, both of which would continue. Thus, individual farmers would have another means and find it easier to double the payment limits.

The bill instructs the Secretary of Agriculture to promulgate regulations to assure that all commodity program payments (made to joint operations, multiple entities, or other financial or management arrangements under the primary control of one person) are counted together toward the $275,000 limit per individual.

The changes proposed in S. 667 would apply to the "covered commodities" and certain loan commodities as a group (wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, other oilseeds, extra long staple cotton, dry peas, lentils, and chickpeas). But peanuts, wool, mohair, and honey are not addressed by S. 667, and thus would remain eligible for the higher limits enacted in the 2002 farm bill, including unlimited use of commodity certificates and forfeiture.

Senate Budget Resolutions. During Budget Committee debate for the FY2005 budget resolution (S.Con.Res. 95, 108th Congress), Senator Grassley added an amendment by a 16-6 vote to reduce mandatory agriculture spending by $1.2 billion and increase mandatory conservation, rural development, and child nutrition spending by the same amount. Although the reduction was stated to come from tighter payment limitations, the resolution did not contain specific reconciliation instructions and would have shifted funds only within the total pool of money available to the Agriculture Committee. With jurisdiction over both commodity and conservation programs, the Agriculture Committee would not have been bound to propose any legislative changes in either program, even if this budget resolution had been adopted.

A year earlier, similar actions were taken for the FY2004 Senate budget resolution (S.Con.Res. 23, 108th Congress). On March 13, 2003, an amendment by Senator Grassley was incorporated by a 14-9 vote to reduce mandatory agriculture spending by $1.4 billion (presumably through payment limitations) and increase mandatory conservation spending by the same amount.

Size of Farms Affected

How many acres can be farmed before reaching the payment limits? **Table 2** presents a simple example for several crops. The example is hypothetical because it assumes only a single crop is grown on a farm and uses national, multi-year averages for yields and prices so that no single year skews the results. Nonetheless, the table provides a useful comparison across different crops based on program rules. Estimates are for a single entity only, without using the doubling rules.

The table shows how cotton and rice farms can reach one or more of the payment limits with fewer acres than wheat, corn, or soybeans. This is especially noticeable since cotton and rice farms tend to be larger, as indicated by the Census of Agriculture. Cotton requires the smallest acreage to reach the marketing loan limit, especially important if certificates become subject to the limit.[3]

For direct payments, the table shows that an average wheat farm could have 2,320 base acres before reaching the $40,000 limit. A rice farm would reach the limit with only 351 acres. If the maximum counter-cyclical payment were paid (that is, the season average market price is less than the loan rate), a wheat farm would reach the $65,000 limit with 3,631 acres. The rice farm would need only 813 acres. Thus, the direct payment limit is more binding than the counter-cyclical payment limit for wheat, corn, soybeans and rice, but counter-cyclical payments are more restrictive for cotton.

For marketing loans, assuming that commodity certificates are not used to avoid payment limits, the $75,000 limit would not be reached until the wheat farm exceeded 4,329 acres, or 1,712 acres for a cotton farm.

Table 2. Example of Acreage Needed to Reach Payment Limits Under the 2002 Farm Bill

Planting a single crop, without doubling the payment limits:	**Wheat**	**Corn**	**Soybeans**	**Cotton**	**Rice**
Base acres to reach $40,000 direct payment limit	2,320	1,323	2,971	1,176	351
Base acres to reach $65,000 with max. counter-cyclical pmt.	3,631	1,771	5,901	928	813
Acres to reach $75,000 LDP based on avg. harvest price	4,329	2,347	4,267	1,712	3,236
In comparison with:					
Actual average acreage (multiple crops possible on the same farm)	241	162	186	420	336
Data:					
2002 farm bill					
Direct payment rate	$0.52/bu.	$0.28/bu.	$0.44/bu.	$0.067/lb.	$2.35/cwt
Target price	3.86/bu.	2.60/bu.	5.80/bu.	0.724/lb.	10.50/cwt
Loan rate	2.80/bu.	1.98/bu.	5.00/bu.	0.52/lb.	6.50/cwt
U.S. avg. yield/acre, 1998-2001	42 bu.	136 bu.	38 bu.	642 lb.	61 cwt
Payment yield (at 93.5%)	39 bu.	127 bu.	36 bu.	600 lb.	57 cwt
Harvest price, avg. 1998-2001	$2.39/bu.	$1.75/bu.	$4.54/bu.	$0.452/lb.	$6.12/cwt
Season price, avg. 1998-2001	2.63/bu.	1.90/bu.	4.62/bu.	0.462/lb.	6.17/cwt

Source: CRS.
Note: Actual acreage from 1997 Census of Agriculture. Assumes one crop per farm, ignoring planting flexibility and not using doubling rules. Prices and yields from USDA World Agricultural Supply and Demand Estimates. Payment yields computed using a base updating formula in the 2002 farm bill (93.5% of the 1998-2001 average. Payment acres=85% of base acres. In reality, an individual would use farm-level yields, with annual production and prices to determine marketing loans and counter-cyclical payments.

[3] For more analysis, see *Farm Level Projections of the Impacts of Payment Limitations*, Agricultural and Food Policy Center (Texas A&M), June 2003, at [http://www.afpc.tamu.edu/pubs/3/402/bp-2003-02.pdf]; *Analysis of Stricter Payment Limitations*, Food and Agriculture Policy Research Institute (University of Missouri), June 2003, at [http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_05_03.pdf]; and *Analysis of Stricter Payment Limits: Additional Information*, June 2003, at [http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_06_03.pdf].