Order Code RS21779
Updated December 13, 2004

CRS Report for Congress
Received through the CRS Web

Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans

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Summary

Federal law has authorized farm income and commodity price support programs for over 70 years. The 2002 farm bill (P.L. 107-171) authorizes the current programs for the 2002-2007 crop years. The payment framework combines direct payments of the 1996 farm bill (P.L. 104-127) with counter-cyclical payments of prior laws. Subsidies continue for wheat, feed grains, upland cotton, and rice, and soybeans and peanuts are added to the list of major crops. Dry peas, lentils, and chickpeas were added to the loan program, and wool, mohair, and honey were reinstated. The law continues to allow planting flexibility and does not require acreage reduction.

Payments for each crop year can be spread out for up to 23 months. The Congressional Budget Office projects FY2005 outlays of $13.5 billion for farm commodity, conservation, and export programs, $8.4 billion of which are for the covered commodities and peanuts. This report will be updated as events warrant.

Legislative Background

Since the 1930's, federal law has required the U.S. Department of Agriculture (USDA) to offer price and income support to producers of certain farm commodities.[1] Authority comes from three permanent laws: the Agricultural Adjustment Act of 1938 (P.L. 75-430), the Agricultural Act of 1949 (P.L. 81-439), and the Commodity Credit Corporation (CCC) Charter Act of 1948 (P.L. 80-806). Congress typically alters provisions in these laws through multiyear farm bills or appropriations acts.

The most recent authorizing legislation, the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, or the 2002 farm bill), was signed into law on May 13, 2002. This

[1] For more information about the history of federal farm income support programs, see CRS Report 96-900, *Farm Commodity Legislation: Chronology, 1933-2002.*

law temporarily suspends most provisions of the permanent laws. Title I contains provisions regarding farm income and commodity price support programs for the 2002-2007 crop years. It replaced the Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (P.L. 104-127), including provisions for the 2002 crop year. Other titles in the law affect conservation, trade, nutrition, credit, rural development, and research.

Eligible Commodities. This report covers grains, cotton, oilseeds, and peanuts. These commodities have similar rules, and generally account for about two-thirds of CCC outlays. Payments for dairy, sugar, and tobacco are outside the scope of this report.[2]

The 2002 farm bill defines two classes of commodities: "covered commodities" and "loan commodities." Covered commodities include wheat, feed grains (corn, grain sorghum, barley, and oats), upland cotton, rice, soybeans, and other oilseeds (sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, and sesame seed). Loan commodities include the covered commodities, plus extra long staple cotton, wool, mohair, honey, dry peas, lentils, and small chickpeas.[3] Peanuts are classified separately, but receive the same types of payments as covered commodities.[4]

Eligible Producers. To receive payments, an individual must share in the risk of producing a crop and comply with conservation and planting flexibility rules. If a landlord receives a fixed cash rent, then the tenant bears all the risk and receives the government payment. Tenants might not benefit fully, though, if landlords raise cash rents or switch to share rental agreements. Agricultural economists widely agree that a large fraction of government payments passes through to landlords, and that government payments raise the price of land. About 60% of acres enrolled in the program are rented.[5]

Types of Payments

Commodity program payments under the 2002 farm bill combine the direct payment framework of the 1996 farm bill with counter-cyclical payments in preceding laws. Depending on the crops farmers grow or have a history of planting, they can receive three types of payments: direct payments, counter-cyclical payments, and marketing loans.

Each payment has an annual limit per farm or individual, but these limits, in practice, are not constraining because some large farms can be reorganized to meet the rules, or marketing loans can be repaid in such a way as to avoid the limits. Legislation was

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[2] See CRS Report RS21999, *Farm Commodity Programs: Summary, Issues, and CRS Products*.

[3] Covered commodity, loan commodity, and other oilseed are defined in Title I, Section 1001, of P.L. 107-171 (7 U.S.C. 7901). Payments for covered and loan commodities are enumerated in Title I, Subtitles A and B (7 U.S.C. 7911-7939). Crambe and sesame seed were added later in the FY2004 Consolidated Appropriations Act (P.L. 108-7, Division A, Title VIII, Sec. 763).

[4] The peanut program is enumerated in Title I, Subtitle C, of P.L. 107-171 (7 U.S.C. 7951-7960). In addition to becoming eligible for direct and counter-cyclical payments, quota owners were compensated with a one-time buyout of 55¢/lb for the quotas that are no longer used.

[5] USDA Economic Research Service, "Decoupled Payments: Household Income Transfers in Contemporary U.S. Agriculture," AER-822, Feb. 2003, 29 pp.

introduced in the 108th Congress (S. 667) to further restrict payment limits. For more information, see CRS Report RS21493, *Payment Limits for Farm Commodity Programs*.

Direct Payments. The 1996 farm bill created production flexibility contract (PFC) payments, and the 2002 farm bill renamed them direct payments. These annual payments are unrelated to (decoupled from) current production or current market prices. The farmer is not obligated to grow the crop to receive a direct payment, and may plant any crop (with the exception of fruits and vegetables) without losing benefits.[6]

The 2002 farm bill preserves direct payments for wheat, feed grains, cotton, and rice, and extends them to previously uncovered soybeans, minor oilseeds, and peanuts. As with the prior law, the direct payment is based on 85% of the eligible "base acres" multiplied by the "direct payment yield" for each farm and the "payment rate" per unit (**Table 1**). For more information about crop bases and payment yields, see CRS Report RS21615, *Updating Crop Bases and Yields Under the 2002 Farm Bill*. The annual limit on direct payments is $40,000 per person, and can be doubled under certain rules.

Counter-Cyclical Payments. Automatic payments when market prices are low were first implemented in 1973, but were discontinued in the 1996 farm bill. The 2002 farm bill reinstates such payments for grains and upland cotton and now extends them to soybeans, other oilseeds, and peanuts.[7] Counter-cyclical payments, formerly called deficiency payments, make up for the difference between a crop's target price and a lower season-average market price. The target price is a statutory benchmark defined in the farm bill (**Table 1**). When market prices exceed the target price, no payment is made.

As with direct payments, counter-cyclical payments are tied to a farm's base acres and "counter-cyclical payment yield" and do not depend on current production. Thus, even though the counter-cyclical program depends on market prices, it does not require the farmer to market any of the relevant commodity. The annual limit on counter-cyclical payments is $65,000 per person and can be doubled under certain rules.

Other payments are considered "counter-cyclical" also. For example, loan deficiency payments (described below) are counter-cyclical because they increase as prices fall.

Marketing Loans and Loan Deficiency Payments. Commodity loans have long been part of farm policy, but the current form of marketing loans and loan deficiency payments (LDPs) began with the 1985 farm bill to keep the storage requirements of the loan program from distorting supply.

Marketing loans are nonrecourse loans that farmers can obtain by pledging their harvested commodities as collateral. The loans provide interim financing by allowing farmers to receive some revenue for their crop when the loan is requested, while at the same time storing the commodity for later disposition when prices may be higher. LDP's are an alternative to taking out a loan, and allow farmers to market grain at any time in response to market signals while receiving the benefits of the loan program.

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[6] Direct and counter-cyclical payments follow annual contracts. For 2005 crops, the contract deadline is June 1, 2005. A $100 late fee allows late registration until September 30, 2005.

[7] Milk also has a new counter-cyclical payment, but with a different payment mechanism.

Table 1. Support Prices for Grains, Cotton, Oilseeds, and Peanuts

Type of payment	Direct Payment	Counter-cyclical	Marketing Loan
Price or amount used in payment formula	Payment rate	Target price	Loan rate (national average)
Crop years	2002-2007	2002-2003 / 2004-2007	2002-2003 / 2004-2007
Payment based on	Historical base acres and yield		Actual production
"Covered commodities"			
Wheat, $/bu	0.52	3.86 / 3.92	2.80 / 2.75
Corn, $/bu	0.28	2.60 / 2.63	1.98 / 1.95
Sorghum, $/bu	0.35	2.54 / 2.57	1.98 / 1.95
Barley, $/bu	0.24	2.21 / 2.24	1.88 / 1.85
Oats, $/bu	0.024	1.40 / 1.44	1.35 / 1.33
Upland Cotton, $/lb	0.0667	0.724	0.52
Rice, $/cwt	2.35	10.50	6.50
Soybeans, $/bu	0.44	5.80	5.00
Minor Oilseeds, $/lb	0.008	0.098 / 0.101	0.096 / 0.093
Other commodities			
Peanuts, $/ton	36	495	355
ELS cotton, $/lb	*	*	0.7977
Wool, graded, $/lb	*	*	1.00
Wool, nongraded, $/lb	*	*	0.40
Mohair $/lb	*	*	4.20
Honey, $/lb	*	*	0.60
Peas, dry, $/cwt	*	*	6.33 / 6.22
Lentils, $/cwt	*	*	11.94 / 11.72
Chickpeas, small, $/cwt	*	*	7.56 / 7.43

* not applicable.
Source: CRS, compiled from the Farm Security and Rural Investment Act of 2002 (P.L. 107-171), Title I, Sections 1103, 1104, 1202, 1303, 1304, 1307, 1401, 1501, and 1502.

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

- loan deficiency payments (LDPs) — a direct payment instead of a loan,
- marketing loan gains (MLGs) — repaying a loan at a lower market price (the posted county price, or the average world price for cotton and rice),
- "commodity certificates" — purchased at the posted county price to repay the loan, with similar results as MLGs but without payment limits,
- forfeiting the collateral (commodity) and keeping the principal (cash).

The "covered crops" and peanuts are eligible; extra long staple (ELS) cotton also is eligible, but not for LDPs. The 2002 farm bill reinstated loans for wool, mohair, and honey, and added dry peas, lentils, and small chickpeas.

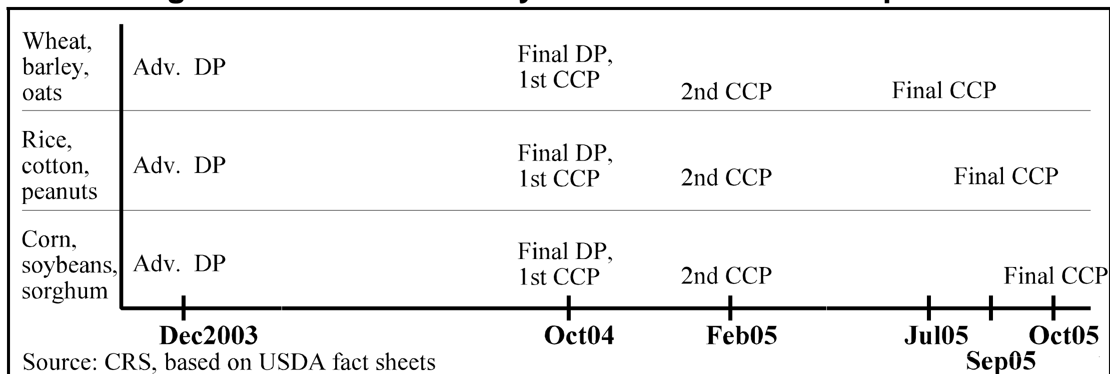
Marketing loans provide minimum price guarantees on the crop actually produced, unlike direct or counter-cyclical payments, which are tied to historical bases. The farm bill sets loan rates at the national level (**Table 1**), but USDA adjusts these to local loan rates to reflect spatial difference in markets, transportation and other factors.[8] The annual limit on marketing loan gains and LDPs is $75,000 per person, and this limit can be doubled under certain rules. However, gains from using commodity certificates or forfeiting commodities are not limited. Thus, the marketing loan program is effectively unlimited.

Timing of Payments

The farm bill establishes a payment schedule. Direct payments (DP) are made in two parts: a 50% advance payment in December, and the balance in the following October. Counter-cyclical payments (CCP) are made in three parts: a first payment in October of the year the crop is harvested of up to 35% of the projected payment, a second payment in the following February, and a final payment at the end of the marketing year. Thus, payments for the 2004 crop began in December 2003 with the advance direct payment, and will end by October 2005 with the final counter-cyclical payment (**Figure 1**). For tax deferral or other reasons, producers can elect to not receive advance or partial payments.

Marketing loans are available anytime after the commodity is normally harvested until a specified date in the following calendar year (e.g., for corn, from fall harvest until May 31). Marketing loans mature nine months after a loan is obtained.

Figure 1. Time Line of Payments for the 2004 Crop Year



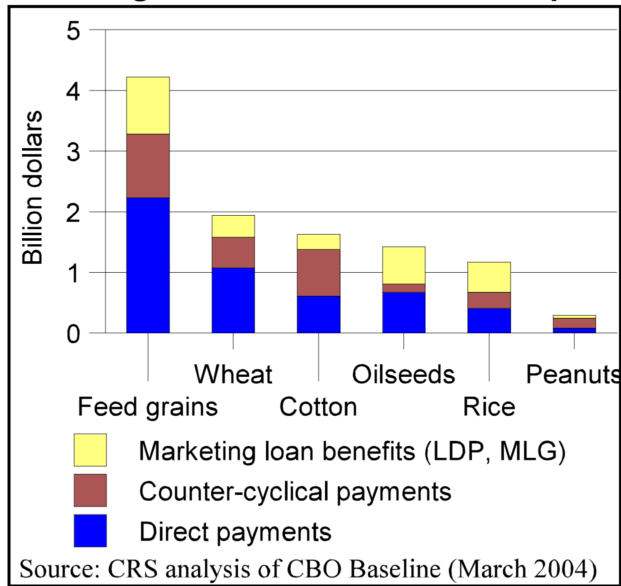
Federal Spending on Commodity Programs

The 2002 farm bill covers crop years 2002-2007. Given the timing of payments, federal outlays for these crop years will be made primarily in FY2003-2008. The Congressional Budget Office (CBO) periodically estimates a baseline for agricultural programs. These estimates account for projections of production, inventories, and prices.

[8] Local loan prices are on the USDA website, [http://www.fsa.usda.gov/dafp/psd/LoanRate.htm].

Figure 2 shows the average annual projected outlays over the life of the farm bill for the major "covered commodities" and peanuts. Feed grains are projected to receive the most support, although the average is raised by higher projected payments in FY2006-FY2008. Direct payments are the largest type for most crops, but projected counter-cyclical and marketing loan benefits are large also, especially for cotton and rice.

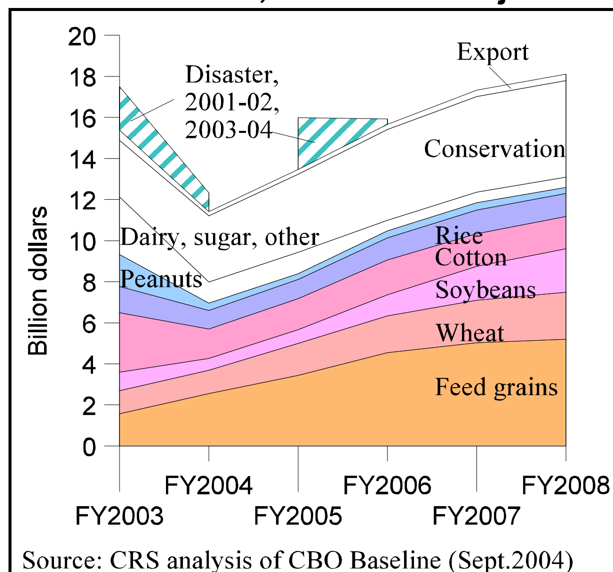
Figure 2. Commodity Program Outlays, Average FY2003-08, Selected Crops



Source: CRS analysis of CBO Baseline (March 2004)

For FY2005, farm commodity supports for all eligible commodities are expected to total $9.4 billion, most of which, $8.4 billion or 89%, is support for grains, cotton, oilseeds, and peanuts (the shaded regions in **Figure 3**). Conservation adds another $3.8 billion, and export assistance programs about $240 million, totaling $13.5 billion in FY2005 for the major agricultural provisions in the 2002 farm bill. In addition to these farm bill programs, disaster assistance for the 2003-04 crop years in the FY2005 military construction appropriation act (P.L. 108-324) will add another $2.5 billion in FY2005 for crop, livestock, and tree losses (the hatched region in Figure 3).

Figure 3. Commodity Support, Conservation, and Export Assistance, FY2003 Actual, FY2004-08 Projected



Source: CRS analysis of CBO Baseline (Sept.2004)

In the September 2004 baseline, CBO projects that outlays will increase for feed grains, wheat and oilseeds, but that outlays for cotton will decrease moderately and stabilize. Outlays for peanuts were especially high in FY2003 because most landowners chose to receive proceeds from the peanut quota buyout program in a lump sum.