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Farm Commodity Programs: A Short Primer

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Summary

The U.S. Department of Agriculture (USDA) is required by law to subsidize approximately two dozen specified agricultural commodities. Several permanent statutes provide the basic authority for these subsidies; more recent multi-year farm bills shape their operation and funding levels. The most recent omnibus farm bill is the Farm Security and Rural Investment Act of 2002 (P.L.107-171). However, Congress since FY1989 has also passed 30 appropriations, authorization, or farm disaster acts adding approximately $53 billion in supplemental funding for USDA farm and related programs (through October 2004). This report will not be updated.

Overview

USDA commodity and price support programs represent the heart of U.S. farm policy, by virtue of their long history and cost. Net outlays for the Commodity Credit Corporation (CCC), USDA's program financing mechanism, have averaged nearly $15 billion annually from FY1995 to FY2004.[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). Congress frequently alters provisions of these laws through omnibus, multi-year farm bills, and through various budget measures. The most recent omnibus farm law is the Farm Security and Rural Investment Act of 2002 (P.L.107-171). This law is effective through 2007.

In addition to passing omnibus farm laws, Congress frequently provides supplemental funding for USDA farm and related programs. From FY1989 through early FY2005, Congress passed 30 appropriations, authorization, or farm disaster acts adding

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

approximately $53 billion in such supplemental funding, over and above amounts authorized in the omnibus laws.[2]

The law requires USDA to offer income and/or price support for wheat, feed grains (corn, sorghum, barley, oats), cotton (upland and extra-long staple — ELS), rice, soybeans, other oilseeds (sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed), milk, peanuts, beet and cane sugar, wool, mohair, honey, dry peas, lentils, and small chickpeas.

Receipts for these commodities represent approximately 35%-40% of all farm cash receipts (estimated at $233 billion in 2004). Other commodities that normally receive no direct support include meats, hay, poultry, fruits, nuts, vegetables, and nursery/greenhouse products. But even producers of these items can be affected by farm policy decisions: they also might raise some price-supported commodities, and can benefit also from periodic laws providing them with their own supplemental disaster or economic relief.[3] Also, 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, each generally designed to achieve these broad objectives:

- To ***supplement farmer incomes***. Tools include annual *fixed decoupled payments* and *counter-cyclical deficiency payments for* grains, cotton, oilseeds, and peanuts; *counter-cyclical deficiency payments* for milk; and *nonrecourse marketing loans* and *loan deficiency payments* for grains, cotton, peanuts, oilseeds, wool, mohair, honey, dry peas, lentils and small chickpeas;

- To ***manage supplies and support commodity market prices***. *Marketing allotments* for sugar are available to restrict output. *Surplus purchases* help support farm prices for milk and various specialty crops.

The types and levels of support employed vary by commodity. Some are supported by only one method; others receive their support through a combination of program tools.

Wheat, Feed Grains, Upland Cotton, Rice, Peanuts, Soybeans, and Other Oilseeds. Eligible producers (those with past production histories for these crops) can receive *fixed, decoupled payments* each year (see rates in table); along with *counter-cyclical deficiency payments*, which make up the difference between the crop's average market price plus the fixed payment and its "target price" (see table), which is

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[2] These supplemental funds are included in the CCC spending cited on page 1. See also CRS Report RL31095, *Emergency Funding for Agriculture: A Brief History of Supplemental Appropriations, FY1989-FY2005*.

[3] For example, the 2002 farm law required USDA to pay apple growers $94 million to cover 2000 market year losses, and to spend $200 million annually to purchase fruits, vegetables, and specialty crops under the Section 32 program. See also "USDA Discretionary Support," page 4.

pegged to past production. Both payments to a producer are based on 85% of the farm's past production history, i.e., past acreage planted times per-acre yield, calculated under formulas in the 2002 farm law. Payment recipients can plant many combinations of crops on their land; they are not bound by the annual, USDA-imposed supply management rules for each crop in effect prior to 1996. Some restrictions do exist: for example, land generally cannot be replanted to fruits and vegetables, and conservation rules must be followed, on subsidized farms.

Crop	Loan Rates	Fixed Decoupled Payment Rates	Counter-Cyclical Target Prices
	2002/03, 2004/07*	2002-2007	2002/03, 2004/07*
Wheat, $/bu	2.80, 2.75	0.52	3.86, 3.92
Corn, $/bu	1.98, 1.95	0.28	2.60, 2.63
Sorghum, $/bu	1.98, 1.95	0.35	2.54, 2.57
Barley, $/bu	1.88, 1.85	0.24	2.21, 2.24
Oats, $/bu	1.35, 1.33	0.024	1.40, 1.44
Cotton, $/lb	0.52, 0.52	0.0667	0.724, 0.724
Rice, $/cwt	6.50, 6.50	2.35	10.50, 10.50
Soybeans, $/bu	5.00, 5.00	0.44	5.80, 5.80
Other oilseeds, $/lb	0.096, 0.093	0.008	0.098, 0.101
Peanuts, $/ton**	355	36	495

* Reflects rates that change in some years.

**Peanut quotas were ended by 2002 law; quota holders also are receiving $220/ton/year for 5 years as compensation.

Producers, regardless of whether they receive the above payments, also are eligible for *nonrecourse marketing assistance loans* and *loan deficiency payments*. (See table for rates.) To qualify, a farmer pledges the stored crop as collateral. Nonrecourse loans generally must be repaid with interest within nine months 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 features are intended to help avert forfeitures, and subsequent buildup of CCC-owned surpluses. First, the "marketing loan" feature enables the farmer to repay the loan at a USDA-calculated rate approximating 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 available to eligible producers who choose *not* to take out a crop loan. (See CRS Report CRS Report RL33271, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*.)

ELS Cotton, Wool, Mohair, Honey, Dry Peas, Lentils, and Chickpeas. Producers of these commodities are not eligible for fixed decoupled or for counter-cyclical payments, but can receive *nonrecourse marketing assistance loans* and (except for ELS cotton) *loan deficiency payments*. Loan rates are specified in the 2002 farm law.

Sugar. A combination of *import quotas* and *nonrecourse loans* is intended to support prices at 18¢/lb.(raw cane) and 22.9¢/lb. (refined beet), at no net cost to the government. *Marketing allotments* limit production to avoid loan forfeitures and CCC costs; also authorized are payments (in the form of CCC-owned sugar) to farmers who agree to *acreage reduction*. (See CRS Issue Brief IB95117, *Sugar Policy Issues*.)

Milk. Price support is provided through surplus *commodity purchases*. The CCC buys bulk cheese, butter, and nonfat dry milk from dairy processors unable to sell them on the private market for at least the prices offered by the CCC. These prices are set so that processors will, in turn, pay farmers a milk price that reflects at least the federally mandated support rate of $9.90 per cwt. Additionally, through September 30, 2005, a "Milk Income Loss Program" offers *counter-cyclical payments* equal to 45% of the difference between $16.94 and the Boston Class I (fluid use) price, whenever that price is lower than $16.94; each farmer's payments are limited to 2.4 million lbs. of annual production (approximately a 120-140-cow herd). (See CRS Issue Brief IB97011, *Dairy Policy Issues*.)

Tobacco. Until recently, the tobacco program had operated under 65 years of supply control and price support. New tobacco quota buyout legislation that eliminates federal tobacco support at the end of the 2004 crop year was signed into law on October 22, 2004 (P.L. 108-357, Title VI, Fair and Equitable Tobacco Reform Act of 2004). Tobacco quota owners and active producers will be paid about $9.6 billion as compensation for lost rents and to aid in the transition to a free market system. Money to pay for the buyout will come from new assessments on tobacco product manufacturers and importers. The payment rate to quota owners is $7/lb. on 2002 basic quota, and the payment rate to active producers is $3/lb. on 2002 effective quota. Payments will be made in equal annual installments for 10 years. In the future, there will be no constraints on who can produce tobacco, where it can be grown, how much can be marketed, or how low the price can go. (See CRS Report RL31790, *Tobacco Quota Buyout Proposals in the 108th Congress.*)

USDA Discretionary Support

In addition to the explicitly-required subsidies described above, federal law has long given USDA the discretion to offer support for virtually any farm commodity. Examples have included *direct payments* of up to $10 per head for **hogs** in 1999, and of up to $8 per head for **lambs** (under a three-year lamb meat adjustment assistance program). Authority and funding for these various activities can come from a number of sources, including CCC (e.g. under the CCC charter act) and Section 32.

Section 32 (of P.L. 320, a 1935 law) permanently appropriates the equivalent of 30% of annual customs receipts to support the farm sector through a variety of activities. Most of this appropriation (now about $6 billion per year) is 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 which up to $500 million annually can be carried over each year), which it uses for "emergency removals" of surplus agricultural commodities, disaster relief, or other unanticipated needs. USDA annually purchases hundreds of millions of dollars in meats, poultry, fruits, and vegetables under Section 32 each year. (See CRS Report RS20235, *Farm and Food Support Under USDA's Section 32 Program*).

Payment and Loan Limitations

Most commodity subsidies are tied to units produced; therefore, higher output (sometimes past, sometimes current, depending upon the subsidy) means higher benefits, with some limits. For grains, cotton, and oilseeds, the law sets an annual ceiling for fixed decoupled payments at $40,000 per person, plus a separate annual ceiling for counter-cyclical payments at $65,000 per person. A separate payment limit of $75,000 per person applies to marketing loans gains for these crops and for dry peas, lentils and chickpeas.

Because an individual can receive *half*-payments on two additional farms, the effective annual cap on total combined payments actually has been $360,000 per person. Limits apply to individuals rather than farm units; thus, a single farm with multiple owners/operators might receive much more than the above amounts. Also, there is no per-person monetary limit on the volume of crops that can be put under CCC loan, or on how much can be forfeited in lieu of loan repayment. Finally, marketing loan gains in the form of USDA-issued commodity certificates (which farmers immediately redeem to satisfy loan repayments) are not counted toward the $75,000 loan cap. Peanuts have separate payment caps, as do wool, mohair, and honey. (See CRS Report RS21493, *Payment Limits for Farm Commodity Programs: Issues and Proposals.)*

Policy Discussion

When the commodity programs were first authorized in the early 1930s, most of the Nation's 6.8 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 — would help to ensure an abundant supply of food and fiber at reasonable prices in the future.

Since then, farming has changed significantly. 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 or so farms are mainly part-time, where operators rely on off-farm sources for most of their income. Farm residents appear to account for less than 2% of the total U.S. population — Census no longer publishes farm population data.

Also, the economic health of farmers has become increasingly tied to the needs of processors and marketers, and to global markets. Critics have long argued that U.S. commodity-based policies are outdated and may even be detrimental to modern agriculture, and to society in general. Although the programs have retained many features dating to the 1930s, they also have evolved — in response both to the changes occurring in agriculture and the economy, and to budgetary and trade pressures. At issue is whether they have evolved quickly enough, or in the most appropriate ways.

Congress and the Administration 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 Federal Agriculture Improvement and Reform Act (P.L. 104-127), written at a time of high farm prices and expanding exports, was aimed at accelerating the programs' market orientation.

However, unanticipated declines in export markets and in farm prices both drove up the projected cost of programs authorized by the 1996 farm law (primarily marketing loans and loan deficiency payments), and also led Congress to enact supplemental aid each year. These record-high subsidies helped the farm economy as a whole remain in relatively strong financial condition. However, most policymakers and farm groups sought a new farm law that would preclude the need for such ad hoc assistance bills. This led to adoption, in the 2002 law, of new counter-cyclical assistance whereby subsidies (for grains, cotton, oilseeds, and milk) automatically increase when farm prices decline, and decrease when they rise (similar to the older target price/deficiency payment subsidies).

This and other commodity provisions in the law attracted widespread criticism from those here and abroad who viewed them as reversing the market-oriented course Congress had charted for long-term farm policy in 1996. These critics have argued that the 2002 bill perpetuated outmoded, commodity-oriented policies that tie support to the prices of a few major row crops; with legislated target prices and loan rates set well above market prices, U.S. producers continue to over-produce supported commodities, distorting market prices and global trade, they argue. (The Bush Administration, in its FY2006 budget proposal, reportedly is calling for reductions in the programs of $5.7 billion over 10 years.) Furthermore, the adoption of expanded farm subsidy programs has undermined U.S. credibility in world trade negotiations, where the United States has called on other countries to reduce their own trade distorting agricultural subsidies, they contend.[4]

Supporters counter that commodity programs provide needed support to farmers who otherwise would see plunging incomes and asset (e.g., land) values due to unfavorable and unpredictable price and market conditions worldwide. The bill maintains market orientation by continuing to give farmers the flexibility to plant crops based on market signals unbound by government supply management rules. The 2002 law has complied with congressional spending limits, and provided no more in subsidies than farmers received under the last omnibus farm law as supplemented by the emergency farm measures, they have noted. The new law contains a so-called "circuit breaker" that requires USDA to cut trade-distorting subsidies in order to remain within the $19.1 billion limit on such spending under the Uruguay Round Agreement on Agriculture. And, the 2002 law keeps the United States in a stronger position to negotiate new agricultural trade reforms: the United States should not unilaterally cut its own subsidies until foreign competitors reduce their own often higher subsidies, as well as their barriers to U.S. farm exports, supporters contend.

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[4] A World Trade Organization panel released findings in 2004 in a case brought by Brazil against U.S. cotton subsidies. The implications for the cotton program could affect payment mechanisms for other commodities (see CRS Report RL32571, *U.S.-Brazil WTO Cotton Subsidy Dispute*).