Order Code RS21493
Updated October 24, 2005

CRS Report for Congress
Received through the CRS Web

Payment Limits for Farm Commodity Programs: Issues and Proposals

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Summary

Payment limits set a maximum dollar amount of farm commodity program payments that a person can receive. Payment limits were created in 1970 and continue in the 2002 farm bill. Federal deficits and public awareness of large payments reaching a small number of large farms have focused congressional attention on the issue.

In the 109th Congress, S. 385 and H.R. 1590 would tighten the limit on direct and counter-cyclical payments, and count commodity certificates toward the marketing loan limit. The Administration also proposed tighter payment limits as part of the FY2006 budget reconciliation. However, the House Committee on Agriculture believes that the 2002 farm bill should not be reopened.

Tighter limits likely would affect more southern cotton and rice farms than midwestern feed grain and oilseed farms. Fewer acres of cotton or rice are needed to reach the limit since payments per acre generally are higher. This report will be updated.

Background on Payment Limits

Payment limits set a maximum dollar amount of farm program payments a "person" can receive (7 U.S.C. 1308). 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, Section 1603).

The issue was controversial when the 2002 farm bill was written, and the policy debate continues today. The debate usually focuses on the purpose of farm programs, reducing federal spending, farm size, and 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 presently are not counted toward the limits).

Who Receives Payments? One-third of all farms in the United States receive subsidy payments, although the ratio is as high as 72% in North Dakota and 70% in Iowa. Ten states received 53% of the total (Texas, Iowa, Georgia, Arkansas, California, Illinois, Nebraska, Minnesota, Kansas, and Mississippi). About 708,000 farm operators and 998,000 landlords received payments, with operators accounting for 54% of payments. The top 5% of recipients received 50% of payments (CRS Report RL32590, *Average Farm Subsidy Payments, by State, 2002*, by Jasper Womach). In addition to individuals, a "person" may include certain corporations, partnerships, and trusts. Many farmers have minimized the impact of payment limits by legally creating multiple entities to receive government payments, even though some policy makers have tried to eliminate such possibilities.[1]

How Many Are Affected by Limits? Little data are available on the current effect of payment limits. The report of the Payment Limits Commission provides data that is valid to compare with only one of the three current payment mechanisms. In 2000, about 1% of producers were affected by the $40,000 limit on what are now called direct payments.[2] This amounted to 12,300 producers across 42 states, with an average reduction of $6,700. The total reduction was $83 million, or 1.6% of the amount of payments. Payment reductions in California ($19.6 million) and Texas ($10 million) represented 36% of the total reduction, and reductions to upland cotton farmers accounted for 60% of the reduction in California and 35% of the reduction in Texas.

How Many Acres Does It Take to Reach the Limit? Data from the USDA Payment Limits Commission show that cotton and rice farms can reach the payment limits with fewer acres than corn, wheat, or soybean farms (**Table 1**). Moreover, cotton and rice farms usually are larger than other farms, further increasing the likelihood that they might reach the limits. In 2002, 14% of farms harvesting cotton had more than 1,000 acres of cotton, compared with only 2.6% of farms harvesting more than 1,000 acres of corn. Although data in the table do not adjust for growing and receiving payments for multiple crops on a single farm, the results are indicative of the general differences between crops.

How Do Variable Costs Compare? USDA's analyzed variable costs relative to the level of government support. For cotton and rice, government payments per acre are generally higher, resulting in fewer acres needed to reach the limit. But variable costs to grow those crops also exceed the costs of other crops. **Table 1** shows that the ratio of support divided by variable costs is 164% and 186% for cotton and rice, respectively, compared with 193%, 218% and 259% for corn, wheat, and soybeans, respectively.[3]

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[1] Food and Agriculture Policy Research Institute (University of Missouri), *Analysis of Stricter Payment Limits: Additional Information*, June 2003, p. 2 [http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_06_03.pdf]; and USDA, *Report of the Commission on the Application of Payment Limitations for Agriculture*, Aug. 2003, pp. 31-39 [http://www.usda.gov/oce/oce/payments/payment-commission.htm].

[2] *Report of the Commission on the Application of Payment Limitations for Agriculture*, pp. 65-75.

[3] For more analysis, see also *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]; and *Analysis of Stricter Payment Limitations*, Food and Agriculture Policy Research Institute (University of Missouri), June 2003, at [http://www.fapri.missouri.edu/

Table 1. Acres Needed to Reach Payment Limits, and Support Relative to Variable Costs

Crop	Acres to reach $40,000 direct payment limit	Acres to reach $65,000 counter-cyclical limit	Farms with 1,000 acres or more of crop	Total support divided by variable cost
Corn	1,636	1,497	2.6%	193%
Wheat	2,623	2,956	6.4%	218%
Soybeans	3,565	5,852	3.3%	259%
Upland cotton	1,176	891	14.0%	164%
Rice	416	823	7.8%	186%

Source: USDA Payment Limits Commission (Tables 4.3-4.5), and 2002 Census of Agriculture

Review of Payments Subject to Limits

Producers generally receive three types of commodity payments: direct payments, counter-cyclical payments, and marketing loan benefits (see CRS Report RS21779, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*, by Jim Monke). Direct and counter-cyclical payments are relatively straightforward since they are direct transfers made in cash. Marketing loans are more complicated since limits do not apply to all four marketing loan mechanisms (see CRS Report RS21604, *Marketing Loans, Loan Deficiency Payments, and Commodity Certificates*, by Jim Monke).

Subject to limits:

- Direct payments
- Counter-cyclical payments
- Some marketing loan benefits
  - — 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:

- Some marketing loan benefits
  - — "commodity certificates": purchased at lower market price and used to repay a loan; same result as MLG, but not counted toward payment limits (P.L. 106-78, Section 812, exempted commodity certificates)
  - — forfeiting the collateral (commodity) and keeping cash from the loan

Other farm programs have payment limits per individual. 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 Incentives Program ($30,000).

Current Payment Limits

Under the 2002 farm bill, the annual payment limit is $360,000 per person. The limit has several components including $40,000 for direct payments, $65,000 for counter-

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[3] (...continued)
outreach/publications/2003/FAPRI_UMC_Report_05_03.pdf].

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 (**Table 2**). However, the marketing loan program is essentially unlimited because when marketing loan gains and loan deficiency payments hit the limit, producers can shift to commodity certificates without limit. One way to double the limit 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. Although payments for most qualifying commodities are combined toward a single limit, separate limits apply to peanuts, wool, mohair and honey.[4]

The 2002 farm bill also created an income test. Payments are prohibited to persons or entities with adjusted gross income (AGI) greater then $2.5 million, unless 75% or more comes from farming.

Table 2. Payment Limits on Farm Commodity Programs

	Current law	Proposals	
	2002 Farm Bill	**S. 385 H.R. 1590**	**Admin. proposal**
Direct and Counter-Cyclical Payments			
(a) Direct Payments	$40,000	$20,000	60,000
(b) Counter-Cyclical Payments	$65,000	$30,000	90,000
Doubling allowance	$105,000	$50,000	None
Subtotal	*$210,000*	*$100,000*	*150,000*
(c) Marketing Loan Payments			
(c1) Marketing Loan Gains plus (c2) Loan Deficiency Payments	$75,000	$75,000	100,000
(c3) Commodity Certificates ** (c4) Loan Forfeiture Gains	No limit		
Doubling allowance	$75,000	$75,000	None
Subtotal of (c1) and (c2)	*$150,000*	*$150,000*	*100,000*
Subtotal including (c3) and (c4)	*No limit*		
Sum of Direct, Counter-Cyclical, and Marketing Loan Payments			
Total of (a), (b), (c1) and (c2)	*$360,000*	*$250,000*	*250,000*
Total including (c3) and (c4)	*No limit*		

Source: CRS.

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

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

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 farm 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 from tighter limits. The report has extensive data on program payments and limits, but the Commission ultimately did not take a position other than that any changes should wait until the next farm bill.

The House Committee on Agriculture stated in its views and estimates letter to the Budget Committee that the 2002 farm bill should not be reopened, and that any changes should wait until the next farm bill.[5] Several members of the House Agriculture Appropriations Subcommittee expressed concern over the Administration's proposal during hearings on February 16, 2005.

S. 385 and H.R. 1590. In the 109th Congress, Senator Grassley introduced S. 385 to tighten limits on direct, counter-cyclical, and marketing loan payments to a total of $250,000, and count commodity certificates and loan forfeiture toward marketing loan limits. An identical bill, H.R. 1590, was introduced in the House. In February 2005, CBO estimated that a plan similar to S. 385 (but without the provision easing single farming operations' ability to double the limit) would save $97 million in FY2006 and $1.2 billion over five years.[6] CBO has not released a specific score of S. 385, but it can be expected to be lower than the figures above.

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 remain the same at $75,000, the effective limit is reduced because commodity certificates and loan forfeiture would be counted toward the limit (**Table 1**). 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.

The bills 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.

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[5] House Committee on Agriculture, Budget Views and Estimates Letter, Feb. 18, 2005 [http://agriculture.house.gov/press/BudgetViewsEstimatesLetter.pdf].

[6] Congressional Budget Office, *Budget Options*, "350-02 Mandatory," Feb. 2005, [http://www.cbo.gov/showdoc.cfm?index=6075&sequence=0].

The changes 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 the bills, and thus would remain eligible for the higher limits enacted in the 2002 farm bill, including unlimited use of commodity certificates and forfeiture.

In 2003, Senator Grassley introduced a similar bill, S. 667 (108th Congress). Tighter limits also were part of the Senate-passed version of the 2002 farm bill (S. 1731, 107th Congress), but those limits were rejected by the conference committee. That bill would have limited direct and counter-cyclical payments to a combined $75,000, allowed a $50,000 spouse benefit, replaced the three-entity rule with direct attribution, limited the marketing loan benefits to $150,000, and counted commodity certificates and forfeiture.

Budget Reconciliation and Administration Proposal. The budget resolution for FY2006, H.Con.Res. 95 (H.Rept. 109-62), includes budget reconciliation instructions that the agriculture authorizing committees find program changes to save $173 million in FY2006 and $3.0 billion over FY2006-10. In the Senate, the Agriculture Committee did not recommend any changes to payment limits in its markup on October 18, 2005.

The Administration's FY2006 budget request also contains a legislative proposals to reduce payment limits, among other farm program changes. The Administration estimates savings from its payment limits plan of $200 million in FY2006 and $845 million over five years.[7] The Congressional Budget Office (CBO) did not score the payment limit proposal with the rest of the Administration's plan because it was not specified sufficiently. The Administration's proposal sets a combined cap of $250,000, includes commodity certificates and loan forfeiture under the limits, removes the three-entity rule, and applies the limits to the dairy program (**Table 1**).

Non-Binding Budget Amendments on Payment Limits. The Senate-passed budget resolution for FY2006 (S.Con.Res. 18) contained a non-binding sense of the Senate amendment by Senator Grassley that any agricultural savings should be achieved primarily through reductions in farm commodity program payment limits; this provision was deleted in conference. 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. A similar amendment was added to the FY2004 Senate budget resolution (S.Con.Res. 23, 108th Congress). All the amendments mentioned in this paragraph did not contain specific reconciliation instructions and would have been nonbinding on the Agriculture Committee.

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[7] Office of Management and Budget, *Major Savings and Reforms in the President's 2006 Budget*, Feb. 11, 2005, pp. 179-181, [http://www.whitehouse.gov/omb/budget/fy2006/pdf/savings.pdf].