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

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Summary

Commodity support provisions in the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the 2002 farm bill) include three primary types of payments: (1) annual direct payments unrelated to production or prices, (2) counter-cyclical payments which are triggered when prices are below statutorily-determined target prices, and (3) marketing assistance loans that offer interim financing and, if prices fall below statutorily-determined loan prices, additional income support.

These programs provide a safety net to protect farmers from falling prices and raise farm income levels. These policies, however, may contribute to world trade distortions, raise land prices and costs of production, and concentrate benefits among certain commodities and producers.

This report describes the payments for wheat, feed grains, cotton, rice, oilseeds, peanuts, wool, mohair, honey, and certain other small grains. These commodities have similar rules, and generally account for about two-thirds of USDA farm commodity program outlays. Examples are provided to illustrate how the payment mechanisms work.

To receive payments, an individual must share in the risk of producing a crop and comply with conservation and planting flexibility rules. Each commodity program has an annual payment 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.

Total actual and estimated payments for these commodities under the 2002 farm bill (FY2003-05 actual and FY2006-08 estimated) range from $6.7 billion in FY2004 to an estimated $14.4 billion in FY2006. Direct payments are nearly constant at $5.2 billion annually. Counter-cyclical payments may range from less than $1 billion in FY2004 to an estimated $5.1 billion in FY2007. Total marketing loan benefits may range from $0.6 billion in FY2004 to an estimated $5.3 billion in FY2006. By commodity, feed grains (primarily corn) clearly receive most of the total support, followed more distantly by cotton, wheat, oilseeds (primarily soybeans), and rice.

This report will be updated if substantial changes occur.

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Background

Economics Shape Perceptions of Subsidies

The economic argument for farm commodity price and income support is that markets do not efficiently balance commodity supply with demand. Imbalances develop because consumers do not respond to price changes by buying proportionally smaller or larger quantities (demand is price inelastic). Similarly, farmers do not respond to price changes by proportionally reducing or increasing production (supply is price inelastic). These imbalances may result in inadequate (or exaggerated) resource adjustments by farmers. Moreover, the long time lag between planting and harvest may magnify imbalances because economic and yield conditions may change.

The objectives of federal commodity programs are to stabilize and support farm incomes by shifting some of the risks to the federal government. These risks include short-term market price instability and longer term capacity adjustments. The goals are to maintain the economic health of the nation's farm sector so that it can utilize its comparative advantages to be globally competitive in producing food and fiber.

Federal law mandates support for a specific list of farm commodities. For most of these commodities, support began during 1930's Depression era efforts to raise farm household income when commodity prices were low because of prolonged weak consumer demand. While initially intended to be a temporary effort, the commodity support programs survived, but have been modified away from supply control and commodity stocks management to direct income support payments.

Critics of commodity programs usually acknowledge the underlying economic conditions that make stability more difficult to achieve for agriculture than some other sectors. However, they argue that (1) current programs are highly distorting of world production and trade, (2) the levels of subsidies are high and have become capitalized into land prices and rents that raise the cost of production and make the United States less competitive in global markets,[1] and (3) the benefits are

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[1] Predictable government payments are capitalized into land values and rents. Since 60% of program acres are rented, the landowners receive many benefits (M. Burfisher and J. Hopkins, "Farm Payments," *Amber Waves*, USDA Economic Research Service, Feb. 2003).

concentrated among a comparatively small number of commodities produced on a small number of large farms.[2]

When farm programs were first authorized in the 1930s, most of the 6 million farms in the United States were small and diversified. Policymakers reasoned that stabilizing farm incomes using price supports and supply controls would help a large part of the economy (25% of the population lived on farms) and assure abundant food supplies. In recent decades, the face of farming has changed. Farmers now comprise less than 2% of the population. Most agricultural production is concentrated in fewer, larger, and more specialized operations. In 2002, about 7% of farms accounted for 76% of the sales (these 151,000 farms had average sales over $1 million). Most of the country's 2 million farms are part-time, and many operators rely on off-farm jobs for most of their income.

Supporters of commodity subsidy programs may not contradict the critics, but do point out that other nations have distorting subsidy programs and/or trade barriers that should be eliminated if the United States is to make reforms. Landowners are concerned about a loss of rents and wealth if land prices drop in response to a reduction in the subsidies. Similarly, rural communities are concerned about any large decline in the real estate tax base that supports local schools, roads, and other community services. While large farms receive most of the production-linked subsidy payments, recipients argue that lower input costs and marketing efficiencies make large farms efficient and small farms uneconomic in the production of bulk commodities. Therefore, targeting subsidies to small farms, recipients say, would encourage inefficient production.

Authorizing Legislation

The authority for the U.S. Department of Agriculture (USDA) to operate farm commodity programs comes from three permanent laws, as amended: 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 alters these laws through multiyear farm bills or annual appropriations acts.[3]

The current 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 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 (7 U.S.C. 7901 *et seq*.). 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 farm bill affect conservation, trade, nutrition, credit, rural development, and research programs and policy.

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[2] J. MacDonald, R. Hoppe, and D. Banker, "Growing Farm Size and the Distribution of Commodity Program Payments," *Amber Waves*, USDA Economic Research Service, Feb. 2005.

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

The Deficit Reduction Act of 2005 (P.L. 109-171) includes net reductions of $2.7 billion over five years for USDA mandatory programs as part of budget reconciliation ordered in the FY2006 budget resolution (H.Con.Res. 95). Most of the reduction in farm programs comes from changing the timing of direct payments, without reducing the overall level of payments to farmers. Not included in the conference agreement is an across-the board cut in commodity payments, which was recommended in the House- and Senate-passed bills. For more on budget reconciliation, see CRS Report RS22086, *Agriculture and FY2006 Budget Reconciliation*, by Ralph M. Chite.

As Congress moves increasingly closer to the 2007 expiration of current farm support programs, policy makers will seek to design a new law that (1) meets the nation's domestic needs, (2) satisfies this country's international trade obligations under the World Trade Organization, and (3) fits within still-to-be determined budgetary constraints. For more information about issues affecting the next farm bill reauthorization, please see CRS Report RL33037, *Previewing a 2007 Farm Bill*, coordinated by Jasper Womach. For summaries on other current policy issues affecting the commodity programs, see CRS Report RS21999, *Farm Commodity Policy: Programs and Issues for Congress*, by Jim Monke.

Eligible Commodities

This report covers wheat, feed grains, cotton, rice, oilseeds, peanuts, wool, mohair, honey, and certain other small grains. These commodities have similar rules, and generally account for about two-thirds of CCC outlays. Payments for dairy and sugar are outside the scope of this report.[4]

The 2002 farm bill defines two classes of commodities: "covered commodities" and "loan commodities." The classes determine which types of payments are available. For example, direct and counter-cyclical payments are available only to the covered commodities, while marketing loan benefits are available to the larger group of 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.[5] Peanuts are classified separately, but receive payments like the covered commodities.[6]

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[4] For dairy programs, see CRS Issue Brief IB97011, Dairy Policy Issues, by Ralph M. Chite. For sugar programs, see CRS Issue Brief IB95117, Sugar Policy Issues, by Remy Jurenas.

[5] Covered commodity, loan commodity, and other oilseed are defined in 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 in the FY2004 Consolidated Appropriations Act (P.L. 108-7, Division A, Sec. 763).

[6] The peanut program is enumerated in Title I, Subtitle C, of the 2002 farm bill (7 U.S.C. 7951-7960).

Eligible Producers

To receive payments, an individual must share in the risk of producing a crop and comply with conservation and planting flexibility rules. A term commonly used in federal regulations is "actively engaged in farming," which generally means providing significant contributions of capital (land or equipment) and labor and/or management, and receiving a share of the crop as compensation. Conservation rules include protecting wetlands, preventing erosion, and controlling weeds. Planting flexibility rules prohibit planting fruits or vegetables on acreage that is eligible for subsidies (discussed more near the end of this report).

Modern farming enterprises usually involve some combination of owned and rented land. Two types of rental arrangements are common: cash rent and share rent. Under cash rental contracts, the tenant pays a fixed cash rent to the landlord, negotiated before the crop is planted. The landlord receives the same rent regardless of the amount harvested, and thus bears no risk. The tenant bears all the risk, receives all of the harvest, and pays most of the expenses of growing the crop. Under share rental contracts, the tenant usually supplies most of the labor and machinery, while the landlord supplies land and perhaps some machinery or management. Both the landlord and tenant receive a portion of the crop harvested as payment for their contribution and may share some input costs.[7] Both bear risk in producing a crop, receiving less if yields and prices are low and more if yields and prices are high.

The 2002 farm bill defines a producer (for purposes of farm program benefits) as an owner-operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to a share of the crop produced on the farm. A landlord receiving crop share as rent is a producer eligible for part of the subsidy payment together with the tenant. But landlords receiving cash rent are ineligible to receive program payments.

Even though tenants might receive all of the government payments under cash rent arrangements, they might not keep all of the benefits if landlords demand higher rent. Economists widely agree that a large fraction of government farm payments passes through to landlords, and that government payments raise the price of land. About 60% of acres enrolled in the government commodity programs are rented.[8]

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 that farmers grow or have a history of planting, they can receive three types of payments based on the values in **Table 1**:

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[7] For example, a typical share rental arrangement in some regions is a 50-50 split of the crop harvested, with landlord supplying all of the land and half of the cost of certain inputs such as fertilizer. The tenant supplies all of the labor and pays the remaining share of the input costs. Management decisions, such as crop diversification, are usually made jointly.

[8] M. Burfisher and J. Hopkins, "Farm Payments," *Amber Waves*, USDA Economic Research Service, Feb. 2003.

- annual **direct payments** unrelated to production or prices,
- **counter-cyclical payments** if market prices are below statutorily-determined target prices, and
- **marketing loans** that provide interim financing and additional income support if market prices fall below statutorily-determined loan prices, sometimes paid as **loan deficiency payments (LDP)**.

Table 1. Support Prices for Agricultural Commodities

(Dollars per unit)

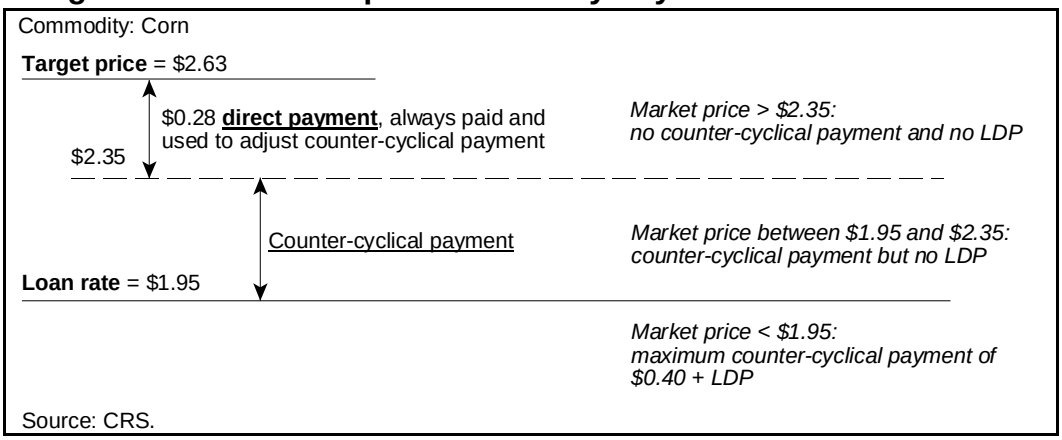
Type of payment	Direct Payment	Counter-Cyclical		Marketing Loan	
Payment is based on	*Historical base acres and yield*			*Actual production*	
Value used in formula	**Payment rate**	**Target price**		**Loan rate (national average)**	
Crop years	2002-2007	2002-03	2004-07	2002-03	2004-07
"Covered commodities"					
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

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, and 1307.

* payment not applicable for this commodity.

Figure 1 illustrates the three types of commodity payments. For simplicity, the figure omits some details such as local loan rates being different from the national loan rate, as explained in later sections. Using corn as an example, if market prices are above $2.35/bushel, neither counter-cyclical nor marketing loan benefits (e.g., LDP) would apply. If market prices are between $1.95 and $2.35/bushel, a counter-cyclical payment would accrue, but no LDP would be available. If market prices are below the loan rate of $1.95/bushel, the maximum counter-cyclical payment of $0.40/bushel is made, and a LDP would be available equal to the difference between the $1.95 loan rate and the market price. Regardless of market prices, however, the direct payment of $0.28/bushel is paid.

Figure 1. Relationship of Commodity Payments to Market Prices



Payment Limitations. Payment limits set a maximum amount of farm commodity program payments that a person can receive. Limits were created in 1970 and continue today. Federal deficits and perceived inequities about the distribution of payments have heightened congressional attention.

Each type of farm subsidy payment has an annual limit per farm or individual, aggregating to a total of $360,000. Moreover, producers with adjusted gross income of over $2.5 million, averaged over each of three years, are not eligible for payments unless more than 75% of adjusted gross income is from agriculture. The $360,000 limit, however, often is 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 has been introduced in the 109th Congress to tighten payment limits to $250,000, and the Administration also proposed similarly tighter limits in 2005 with the FY2006 budget request, and again in 2006 with the FY2007 budget request.

The effect of payment limits varies greatly across individuals and regions. Geographically, the South and West tend to have more large farms affected by payment limits than the Upper Midwest or Northeast. By commodity, cotton and rice farms are affected more often because the subsidy per acre is relatively higher. For more details, see CRS Report RS21493, *Payment Limits for Farm Commodity Programs*, by Jim Monke.

Direct Payments

The 1996 farm bill created production flexibility contract (PFC) payments that are unrelated to (decoupled from) current production or current market prices. The 2002 farm bill renamed them direct payments.[9] A farm is eligible for direct payments in proportion to its base acres, which are a historical average of its planting history of a commodity, as discussed later in this report. A farmer is not obligated to grow the crop to receive a direct payment for that crop, and may plant any crop (with the exception of fruits and vegetables), or no crop, without losing benefits.

The 2002 farm bill preserves direct payments for wheat, feed grains, cotton, and rice, and extends them to soybeans, minor oilseeds, and peanuts, which were previously ineligible. As with the 1996 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**). The direct payment yield is a historical average yield for the farm, recorded similarly to the base acreage. The adjustment factor of 85% reduces the number of acres eligible for payments and was instituted under previous farm bills to reduce Federal expenditures.

The annual limit on direct payments is $40,000 per person, and can be doubled under certain rules.

Because direct payments do not vary with yield or price conditions, total direct payments for all crops remain nearly constant at $5.2 billion per year (**Table 9**).

Example of direct payments. To illustrate how commodity payments are made, consider the following hypothetical example. A 1,000-acre farm in Montgomery County, Illinois, has 400 base acres of corn and 600 base acres of soybeans. Its direct payment yield is 110 bushels/acre for corn and 35 bushels/acre for soybeans. **Table 2** shows that the farm's direct payments would be $10,472 for corn and $7,854 for soybeans, regardless of what crops are actually planted.

Table 2. Example of Direct Payments

Direct payment calculation (2005 crop year)	Corn	Soybeans
Base acres	400 acres	600 acres
Direct payment yield	110 bu./acre	35 bu./acre
Direct payment rate (**Table 1**)	$0.28/bu.	$0.44/bu.
Direct payment	**$10,472.00**	**$7,854.00**
Corn = 0.85 * 400 * 110 * 0.28	**$10,472.00**	
Soybeans = 0.85 * 600 * 35 * 0.44		**$7,854.00**

Source: CRS.

[9] The USDA fact sheet on direct and counter-cyclical payments is available at [http://www.fsa.usda.gov/pas/publications/facts/html/dcp03.htm].

Counter-Cyclical Payments

Counter-cyclical payments are automatic payments when market prices are low. This type of "safety net" payment was first implemented in 1973, but was discontinued in the 1996 farm bill. The 2002 farm bill reinstated counter-cyclical payments for wheat, feed grains, rice, and upland cotton and extended them to soybeans, other oilseeds, and peanuts.[10]

Formerly called deficiency payments, counter-cyclical payments compensate for the difference between a crop's target price and a lower effective market price. The target price is a statutory benchmark defined in the farm bill (**Table 1**). The effective price is the direct payment rate plus the higher of the national season-average market price or the national loan rate. When effective 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 payment rate formula depends on market prices, it does not require the farmer to produce any of the commodity.

The annual limit on counter-cyclical payments is $65,000 per person and can be doubled under certain rules.

Because counter-cyclical payments depend upon market prices, total counter-cyclical payments can vary greatly from year to year. For all crops covered during the 2002 farm bill, counter-cyclical payments may range from less than $1 billion in FY2004 to an estimated $5.1 billion in FY2007 (**Table 9**).

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

> *Example of counter-cyclical payments*. Continuing with the previous hypothetical example, suppose the farm's counter-cyclical payment yield is 125 bushels/acre for corn and 40 bushels/acre for soybeans. Suppose the season-average market price, computed after the end of the 2005 crop's marketing year in September 2006,[11] is above the national loan rates for both corn and soybeans. **Table 3** shows that after adding the direct payment rate to the season-average market price to compute the effective price, the resulting counter-cyclical payment rate is $0.15/bushel for corn and $0 for soybeans. Corn receives a counter-cyclical payment because the effective price is less than the target price, but soybeans do not receive a counter-cyclical payment since the effective price exceeds the target price. The counter-cyclical payment for corn is $6,375, regardless of what crops are planted.

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

[11] The crop year is the calendar year during which a crop is harvested. This contrasts with the marketing year, which is the 12-month period that begins when a crop is harvested and during which the crop is sold.

Table 3. Example of Counter-Cyclical Payments

Counter-cyclical payment calculation (2005 crop year)	Corn	Soybeans
Base acres	400 acres	600 acres
Counter-cyclical payment yield	125 bu./acre	40 bu./acre
Target price (**Table 1**)	$2.63/bu.	$5.80/bu.
Higher of season-average market price or national loan rate	$2.20/bu.	$5.40/bu.
+ Direct payment rate	$0.28/bu.	$0.44/bu.
= Effective price	$2.48/bu.	$5.84/bu.
Counter-cyclical payment rate (higher of target price minus effective price, or zero)	$0.15/bu.	$0.00/bu.
Counter-cyclical payment	**$6,375.00**	**$0.00**
Corn = 0.85 * 400 * 125 * 0.15	**$6,375.00**	
Soybeans = 0.85 * 600 * 40 * 0		**$0.00**

Source: CRS.

Marketing Loans and Loan Deficiency Payments

Marketing loans are nonrecourse loans[12] that farmers can obtain by pledging their harvested commodities as collateral.[13] 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. Loan deficiency payments (LDPs) are an alternative to taking out a loan, and allow farmers to market grain in response to market signals while receiving the benefits of the loan program.

Marketing loans provide minimum price guarantees on the crop actually produced, unlike direct or counter-cyclical payments, which are tied to historical bases. National-level loan prices (**Table 1)** are set by the 2002 farm bill, and were negotiated rather than set based on formulas as in previous farm bills. USDA adjusts these to local loan rates to reflect spatial difference in markets and transportation.[14]

The original purpose of the loan program was to give farmers short-term funds to pay expenses until commodities are sold, hence the name marketing assistance loans. Without such credit, more farmers may be compelled to sell their crop at

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[12] "Nonrecourse" means that the collateral can be forfeited at the end of the term with no penalty. The government takes no recourse beyond accepting the commodity as full settlement of the loan, even if the market price of the commodity is less than the loan.

[13] The USDA fact sheet on marketing loans is available at [http://www.fsa.usda.gov/pas/publications/facts/html/nonrec03.htm].

[14] Local loan prices are available at [http://www.fsa.usda.gov/dafp/psd/LoanRate.htm].

harvest when prices are low and oversupply the market. Marketing loans encourage farmers to sell crops in response to price signals rather than creditor pressure.

The marketing loan program has four mechanisms to provide benefits when market prices are below loan rates:

- **loan deficiency payment (LDP)** — direct payment of loan benefits, instead of taking out a loan and repaying the loan
- **marketing loan gain (MLG)** — repaying a loan at a lower price than the original loan, and keeping the difference as a loan benefit
- **certificate gain** — similar to a MLG but without payment limits; repay a loan with commodity certificates instead of cash
- **forfeiting the collateral** (commodity) and keeping the principal (cash from the loan).

Each transaction is discussed in more detail below. The "covered commodities" (wheat, corn, sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds) and peanuts are eligible for all marketing loan benefits. Extra long staple (ELS) cotton also is eligible, but not for LDPs. The 2002 farm bill reinstated wool, mohair, and honey, and added dry peas, lentils, and small chickpeas to the list of "loan commodities."

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.

Because marketing loan benefits depend on market prices, total marketing loan benefits can vary greatly from year to year. For all crops during the 2002 farm bill, marketing loan benefits may range from $0.6 billion in FY2004 to an estimated $5.3 billion in FY2006 (**Table 9**). The vast majority of marketing loan benefits are paid out as loan deficiency payments (rather than producers actually taking out a loan and receiving marketing loan gains or certificate gains).

A History of Loans Supporting Farm Income

The marketing loan price guarantee is a long-standing element of the federal farm income safety net. But the loan program was not always as market-oriented as it is today, and its role in supporting income used to be greater, especially before the advent of the current program's direct and counter-cyclical payments.

Before changes in 1985 which increased market orientation, the loan program was an important supply management and price support mechanism. To participate in the commodity programs, farmers frequently were required to take land out of production. Every year, USDA would determine the "set-aside" ratio, a percentage of base acres for each commodity to not be planted but placed in a conserving use to control erosion. Set-aside requirements often ranged between 5-15%, with the higher amounts dictated when surpluses were large.

Moreover, to receive the price supports available under the loan program, commodities needed to be placed under loan and stored. Loan prices were higher, and the current loan repayment options did not exist when market prices were below the loan price. Forfeiture was common because many loans matured before market prices rose enough to bring the commodity out of storage. Farmers would let the government take possession of the collateral to satisfy the loan. Large volumes of forfeited grain caused problems because they removed supplies from the market and distorted trade. But when government stocks eventually came out of storage, they sometimes tended to oversupply the market. To reduce this impact, the government donated commodities for food aid programs, diverted them to nontraditional uses, or devised ways to give commodities to farmers as a "payment-in-kind" for continued participation. But many observers viewed the government as an inefficient manager of supplies and stocks, and preferred a stronger market orientation.

The transition away from supply management and price support was gradual, beginning in the 1970s. Loan prices were slowly reduced so as not to interfere with market prices as often. Various production control mechanisms (such as acreage set-asides or diversions, and conservation reserves) helped reduce supplies and support prices. The 1985 farm bill completed the evolution to marketing loans with an explicit policy not to use loans to control market supplies.

The 1996 farm bill went further to separate income support from market intervention. Producers of wheat, feed grains, rice, and upland cotton received annual direct payments from 1996-2002, along with nearly complete planting flexibility. They could plant almost any crop (except fruits and vegetables) without government limits on acreage and still receive income support. Set-aside acres were eliminated. This policy shift was motivated in part by the tendency of other countries to increase production when U.S. farmers were required to cut back on acreage, and the desire to decouple payments from production.

The 2002 farm bill continued the marketing loan program and LDPs, emphasizing that the loan program should minimize accumulation of commodity inventories. It reinstated loans for several commodities that had been cut from the program in 1996 (wool, mohair, and honey), and added dry peas, lentils, and small chickpeas to the list of eligible crops.

Table 4 shows the volume of loan activity from FY2001 to FY2005, and estimates for FY2006. The volume of loans issued fluctuates from $10-12 billion. With the exception of 2001 and 2005, the design of the program has been successful in minimizing the amount of commodities forfeited to about 1-2% of loan volume.

The use of commodity certificates as a way of repaying loans has grown significantly since being introduced in 2000. In FY2000, only 9% of loan repayments were with certificates. In FY2005, 39% were repaid with certificates.

Table 4 also shows the total income support benefits from the loan program. Loan benefits were $8.1 billion in FY2000, and have declined since as market prices have risen. However, in FY2006, marketing loan benefits are expected to return to the $5 billion level.

Table 4. Marketing Loans: Issued, Retired, and Benefits Paid
(Millions of dollars)

	Fiscal year					
	2001	**2002**	**2003**	**2004**	**2005**	**2006***
Loans made	$8,267	$10,131	$10,718	$9,150	$12,619	$11,116
Loans retired:						
Repaid cash	$5,078	$5,675	$6,412	$7,904	$6,819	$6,552
Repaid certs.	2,250	3,749	3,868	903	5,149	4,020
Write-off **	721	642	190	114	318	477
Forfeited	1,085	164	150	25	978	101
Total retired	9,134	10,230	10,620	8,946	13,265	11,149
Benefits to farmers:						
LDP	$5,293	$5,345	$693	$461	$3,856	$4,839
Write-off **	721	642	190	114	318	477
Total benefits	6,014	5,987	883	575	4,174	5,316

Source: USDA Farm Service Agency, "Output 4: Summary of CCC Loan and Inventory Activity," and "Output 50: Total Cash Commodity Payments," *Commodity Estimates Book for FY2007 President's Budget* (Feb. 6, 2006).

* Estimate.
** Write-offs include marketing loan gains & certificate gains (repaying a loan when market prices are below the loan rate).

How Marketing Loans Work

When the producer needs cash but wants to wait to sell the commodity, taking out a loan is feasible regardless of market prices. LDPs are available only if market prices are less than the loan price (also known as the loan rate, which is different from the interest rate charged on marketing loans). Loan prices generally are set below normal market lows, but market prices occasionally drop lower.

Obtaining a Loan. Producers pledge harvested commodities as collateral to obtain interest-bearing nonrecourse loans from the Commodity Credit Corporation (CCC).[15] The value of the loan is the loan price multiplied by the quantity pledged as collateral. Producers may obtain loans any time during a several-month period following harvest. Loans mature in nine months, but may be repaid earlier.

Repaying a Loan. Marketing loans can be retired in three ways:

- repaying in cash,
- repaying using commodity certificates, or
- forfeiting the commodity to the CCC.

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[15] The interest rate charged on commodity loans was 5.375% during December 2005 (1% above CCC's cost of borrowing from the U.S. Treasury, as mandated by the 1996 farm bill). Rates change monthly depending on the government cost of borrowing.

Repaying with Cash. If market prices exceed the loan price when the loan is repaid, the producer repays principal plus interest. Typically, the producer then sells the commodity on the open market for the higher market price.

If market prices are lower than the loan price when the producer decides to repay the loan (that is, the value of the collateral is less than the principal of the loan), the producer repays the loan at the lower price, keeps the difference between the original loan price and the lower repayment price, and retains ownership of the commodity for selling in the open market. The repayment price is called the posted county price (PCP, or adjusted world price for rice and cotton).[16] The difference between the loan price and the lower repayment price is called a marketing loan gain (MLG) and is taxable with farm income as a government payment.

> *Example of a marketing loan*. Continuing the hypothetical example, suppose that during the 2005 crop year the farm actually planted 500 acres of corn and 500 acres of soybeans using the planting flexibility allowed. **Table 5** shows that if actual yields were above average at 135 bushels/acre for corn and 44 bushels/acre for soybeans, the actual production eligible for the marketing loan program would be 67,500 bushels of corn and 22,000 bushels of soybeans. Since the farm is in Montgomery County, Illinois, the local loan rates for the 2005 crop year are $1.96/bushel for corn and $5.12/bushel for soybeans (higher than the national average loan rates according to the Farm Service Agency).
>
> Suppose after harvesting the grain, the producer decided to take out a marketing loan on November 1, 2005, on the entire crop and received the local loan rate on all of the bushels. The loan totaled $132,300 for corn and $112,640 for soybeans. Suppose on January 19, 2006, the farmer decided to repay the loans and market the grain. Since the posted county price (PCP) for corn on January 19 was below the local loan rate, the farmer repaid the corn loan at the lower posted county price, thus receiving a $11,475 marketing loan gain (MLG). Since the PCP for soybeans was above the local loan rate, the farmer repaid the soybean loan at the original loan rate plus interest.

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[16] Posted county prices (PCPs) are determined daily by USDA for 17 commodities in each county in the United States, resulting in 88,000 daily prices. The calculation begins with previous-day prices at nearby terminal markets and then adjusts for CCC's County Average Location Differentials (largely transportation costs) to reflect the local market. Daily PCPs are available online at [http://www.fsa.usda.gov/dafp/psd/default.htm].

Producers sometimes assert that the posted county price in their county does not accurately reflect the local market, and thus that they do not receive the level of payments to which they are entitled. If the PCP is higher than the local cash market price, the marketing loan benefits paid to the farmer will be smaller. This issue was raised in the 1990s, and resulted in USDA making adjustments to it models. In December 2005, the House Agriculture Committee held a hearing on posted county prices to examine recent producer concerns. USDA officials explained the process of daily determining PCPs and efforts to accurately adjust for geographic differences. House Agriculture Committee, *"Review Technical Procedures of USDA's Establishment of Posted County Prices,"* Serial No. 109-24, December 14, 2005 [http://agriculture.house.gov/hearings/109/10924.pdf].

Once the loans are repaid, the farmer can sell the grain to a local elevator for the cash market price. If the farmer were able to sell at a price equal to the posted county price on that day (which may not necessarily be the case but is assumed here), the market revenue from selling the grain would be $120,825 for corn and $118,140 for soybeans. Combining market revenue with government payments (including direct, counter-cyclical and marketing loans), total revenue would be $149,147 for corn and $125,994 for soybeans.

Table 5. Example of Repaying a Marketing Loan

Marketing loan gain (MLG) calculation (2005 crop year)	Corn	Soybeans
Base acres	400 acres	600 acres
Acres actually planted	500 acres	500 acres
Actual yield per acre	135 bu./acre	44 bu./acre
Actual production	67,500 bu.	22,000 bu.
National loan rate (**Table 1**)	$1.95/bu.	$5.00/bu.
Local loan rate (Montgomery County, Illinois)	$1.96/bu.	$5.12/bu.
Farmer obtains a marketing loan on November 1, 2005, and receives cash	$132,300.00	$112,640.00
Posted county price (PCP) on January 19, 2006 when farmer chooses to repay the loan	$1.79/bu.	$5.37/bu.
Farmer repays loan in cash on January 19, 2006 For corn, repaid at the lower PCP For soybeans, repaid at lower loan rate plus interest ($5.12 + interest for 79 days at 5.375%)	$-120,825.00	$-113,950.40
Marketing loan gain (MLG) Corn = $132,300 - 120,825 Soybeans = $0 (interest paid = $1,310.40)	**$11,475.00**	**$0.00**
Farmer sells grain on open market at a cash price assumed equal to the posted county price	$120,825.00	$118,140.00
Total government payments Direct + counter-cyclical + marketing loan gain	$28,322.00	$7,854.00
Total revenue to farmer	$149,147.00	$125,994.00

Source: CRS.

Repaying with Commodity Certificates. Certificates are a relatively new loan repayment option.[17] The outcome is the same as repaying with cash, but the benefit is not counted against the $75,000 payment limit on marketing loan gains and loan deficiency payments.

[17] In October 1999, Congress amended the 1996 farm bill to allow commodity certificates to be issued to repay loans (P.L. 106-78, sec. 812). In February 2000, the Secretary of Agriculture implemented the certificate program. The use of certificates to repay marketing loans continues under the 2002 farm bill.

USDA sells generic commodity certificates only to producers seeking to repay outstanding marketing loans for less than the loan price. The producer buys a certificate at the posted county price (or adjusted world price for rice and cotton) for the quantity of commodity under loan and immediately gives it back to USDA to repay the loan. This extra transaction (of paying cash to buy a certificate and promptly using it to repay the loan, instead of repaying with the same cash) is an accounting maneuver that prevents the gain from counting toward payment limits. The producer can then sell the commodity on the open market as described before.

The overall use of certificates grew dramatically from $635 million in FY2000 to $5.1 billion in FY2005. Some of the increase comes from greater loan volume when prices are low, but certificate use also has grown relative to cash repayments.

Cotton and, to a lesser degree, rice dominate the activity in certificates, and accounted for 71% of certificates issued in FY2000, growing to more than 96% in FY2002-05 (**Table 6**). Only in FY2000, the first year for such certificates, did feed grains, soybeans, or wheat have a noticeable share of the certificate volume.

Cooperative marketing associations (CMAs) account for much of the marketing activity for cotton and rice producers. Producers deliver a commodity to the CMA and authorize it to participate in the marketing loan program on their behalf. CMAs are more common for cotton and rice than for feed grains, wheat, and oilseeds.

Table 6. Use of Commodity Certificates by Crop

(Millions of dollars)

	Fiscal year					
	2000	**2001**	**2002**	**2003**	**2004**	**2005**
Cotton	$253	$1,786	$3,207	$3,206	$569	$4,464
Rice	195	336	428	647	317	447
Oilseeds	36	186	68	0	2	27
Feed grains	93	121	43	8	13	183
Wheat	58	16	3	1	0	1
Peanuts	0	0	0	6	0	26
Dry peas, lentils	0	0	0	0	1	1
Honey	0	4	0	0	0	0
Total	635	2,449	3,749	3,868	902	5,149
% cotton	40%	73%	86%	83%	63%	87%
% rice	31%	14%	11%	17%	35%	9%

Source: USDA Farm Service Agency, "Output 18: CCC Certificate Exchange Costs," *Commodity Estimates Book for FY2007 President's Budget* (Feb. 6, 2006).

Forfeiting the Commodity. Forfeit effectively results in selling the commodity to the government at the loan price. This option is available due to the nonrecourse nature of the loan. Forfeiture was more common before the 1985 farm bill, when storing commodities was necessary to participate in the loan program, and before loan deficiency payments were created. Very little of any commodity is forfeited under the current farm programs, because the programs are designed to discourage that activity.

Taking the LDP Option. When market prices are below loan prices, producers may choose to bypass the loan process and receive LDPs equal to the difference between the local loan price and the lower posted county price (or adjusted world price). LDPs offer similar income benefits to marketing loan gains and are also taxable. The availability of LDPs reduces the amount of grain placed under loan and allows producers to market grain without loan collateral restrictions.

Example of a loan deficiency payment (LDP). Continuing with the hypothetical example, suppose the producer decided not to take out a loan but rather chose to receive a loan deficiency payment. **Table 7** shows that on January 19, 2006, the LDP would have been $0.17/bushel for corn and $0 for soybeans, based on the posted county prices (PCP) for that date. For the entire crop of corn, the total LDP on that day would have been $11,475. Note that this is the same result as for the marketing loan gain in **Table 5** since it uses the PCP from the same day.

Table 7. Example of a Loan Deficiency Payment

Loan deficiency payment (LDP) calculation (2005 crop year)	Corn	Soybeans
Actual production	67,500 bu.	22,000 bu.
Local loan rate (Montgomery County, Illinois)	$1.96/bu.	$5.12/bu.
Posted county price (PCP)on January 19, 2006 when LDP option is exercised	$1.79/bu.	$5.37/bu.
Loan deficiency payment rate (higher of local loan rate minus posted county price, or zero)	$0.17/bu.	$0.00/bu.
Loan deficiency payment (LDP) Corn = 67,500 * 0.17 Soybeans = 22,000 * 0	**$11,475.00**	**$0.00**

Source: CRS.

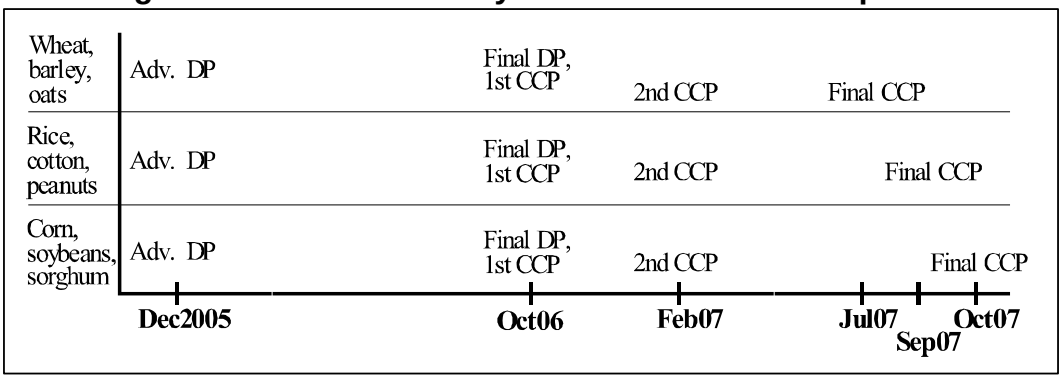
The various loan repayment and LDP provisions accomplish several objectives. By avoiding forfeiture, the government avoids the costs and complications of inventory storage and disposal. Farmers retain possession of the commodities and make marketing decisions, rather than the CCC taking possession and possibly accumulating market-distorting stocks.

Farmers generally appreciate the marketing flexibility and sometimes have been able to sell their commodity for more than the loan repayment price. In such cases, however, the farmer is exposed to market price volatility and is speculating once the LDP is taken or the loan is repaid. This practice, however, has become commonplace in rural America, with market advisory services recommending particular weeks when farmers should "lock-in" their LDP (usually near harvest when prices are low), and when later in the marketing year that farmers should sell their commodity in the cash market when prices are usually higher.

Timing of Payments

The 2002 farm bill establishes a payment schedule for each type of commodity payment. Direct payments (DP) are made in two parts: an 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 after the season-average market price is determined. Thus, payments for the 2006 crop began in December 2005 with the advance direct payment, and will end by October 2007 with the final counter-cyclical payment (**Figure 2**). For tax deferral or other reasons, producers can elect to not receive advance or partial payments.

Figure 2. Time Line of Payments for the 2006 Crop Year



Source: CRS, based on USDA fact sheets

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.

The portion of direct payments made in advance is reduced under the Deficit Reduction Act of 2005 (P.L. 109-171). The 2002 farm bill allowed up to 50% of direct payments in advance of the crop year. The reconciliation law reduces the advanced payment rate to 40% in the 2006 crop year and to 22% in 2007. Only the portion paid in advance is changed; the total direct payment is not reduced.

However, the Deficit Reduction Act of 2005 was enacted on February 8, 2006, *after* the advanced direct payments for the 2006 crop year were paid in December 2005. Thus, the reduction originally envisioned for the 2006 crop year (and the 2006 fiscal year) will not be achieved. However, the same budgetary savings will accrue all in one year (FY2007) when the advance payment ratio drops from 50% to 22% for the 2007 crop year. Reducing the advance payment rate is scored as a one-time savings.[18] For more information, see CRS Report RS22086, *Agriculture and FY2006 Budget Reconciliation*, by Ralph M. Chite.

[18] Congressional Budget Office, *Cost Estimate: S. 1932, Deficit Reduction Act of 2005*, January 27, 2006, p. 10 [http://www.cbo.gov/ftpdocs/70xx/doc7028/s1932conf.pdf].

Base Acreage

Every farm participating in the government commodity program has a unique "base acreage," "direct payment yield," and "counter-cyclical payment yield" recorded with the USDA's Farm Service Agency (FSA) for each of the "covered commodities" and peanuts. These bases and yields are used to calculate direct and counter-cyclical payments, but are unrelated to the marketing loan program. Under the 2002 farm bill, there are 268.6 million base acres of the program commodities. Corn, wheat, and soybeans account for 81% of the total base acres (**Table 8**).

A farm's base acreage and payment yield depend on its planting history of the crop, and can change only when bases are allowed to be updated. Certain exceptions allow prevented plantings to be counted as planted acres after droughts or floods. Farmers report acreage and yields annually to their local FSA county office.

The formula for both direct and counter-cyclical payments uses a definition of "payment acres" equal to 85% of base acres. This adjustment reduces program costs, and has been used in previous farm bills. The direct payment equals the payment acres multiplied by the direct payment yield and a fixed payment rate established in the farm bill for each crop. The counter-cyclical payment is similar, but uses a payment rate tied to season-average market prices.

Table 8. Base Acres and Actual Plantings

Commodity	Millions of acres		Percent of base acres planted
	Base acres	Actual planting in 2005 crop year	
Corn	87.7	81.6	93%
Wheat	76.1	58.1	76%
Soybeans	53.3	73.3	138%
Cotton	18.6	14.0	75%
Sorghum	12.1	7.0	58%
Barley	8.8	4.0	45%
Rice	4.5	3.3	73%
Oats	3.1	4.3	139%
Other oilseeds	2.9	5.0	172%
Peanuts	1.5	1.6	107%
Total	**268.6**	**252.2**	**94%**

Source: CRS, using USDA data.

Planting Flexibility

The law gives farmers considerable flexibility to plant nearly any crop (except fruits and vegetables) on base acres and still receive payments.[19] Planting flexibility refers to the ability to receive subsidy payments for a base crop (such as corn), but to grow a different crop on those base acres (such as soybeans). Planting flexibility was introduced in the 1990 farm bill, and is meant to allow farmers to respond to market signals when choosing crops. Any crop may be grown on base acres, with the exception of fruits and vegetables which are restricted to protect growers who do not receive payments. In recent years, farmers have planted fewer acres of wheat, rice, and cotton than were registered as base acres, while planting more acres of soybeans, other oilseeds, and oats than are registered as base acres (**Table 8**).

The 2002 farm bill allows limited exceptions to the fruit and vegetable protections only for growers with a history of such planting (P.L. 107-171, Sec. 1106 (c)). Legislation has been introduced in the 108th and 109th Congress to expand planting flexibility. For more on these issues, see CRS Report RS21999, *Farm Commodity Policy: Programs and Issues for Congress*, by Jim Monke.

Updating Bases and Yields in the 2002 Farm Bill

The 2002 farm bill offered farmers a rare opportunity to update their program base acreage and yields (P.L. 107-171, Sec. 1101-1102). Previous farm bills had frozen program yields since 1985, and base acreages since 1996. Moreover, even when base acreages could be increased in the 1980s and early 1990s, many farmers did not change their base acreages because they would lose program benefits while establishing a different planting history. Thus, for the vast majority of farmers who participated annually, bases and yields had not been updated for over a decade.

Now that they have been updated, bases and yields are frozen until at least the 2007 crop year when the 2002 farm bill expires. USDA implemented five options based on the statute, most using the production flexibility contract (PFC) base from the 1996 farm bill as a starting point. For updates, the four-year period 1998-2001 was used to determine "average" plantings and yields. Peanut base was limited to "historic growers" during 1998-2001 when the peanut quota system existed.

USDA tracked the decisions of the 2.1 million eligible farms that had PFC acreage from the 1996 farm bill and/or a planting history of at least one covered commodity between 1998 and 2001. Results indicate that 41% of farms chose to establish new base acreages using only their planting histories from 1998-2001. Nearly three-fourths of this subset (28% of the total) also chose to update their counter-cyclical program yields. Another 35% of farms chose to add oilseed acreage to their existing 1996 base acreage. Thus, 76% of farms made some change to their base acres. The remaining 24% of farms chose to make no changes.

Certain regions preferred different options. **Figure 3** shows that a majority of farms in the western Great Plains kept their 1996 base acreage with no changes.

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[19] Planting flexibility is legislated in P.L. 107-171, section 1106 and section 1306.

Figure 4 illustrates that adding oilseeds to 1996 base was preferred by majorities throughout many parts of the Midwest (particularly Iowa), northern Great Plains, Southeast, and west Southwest. **Figure 5** indicates that updating all bases was the majority choice in central Illinois and near the border of South Dakota and Minnesota.

Figure 3. Percent of Farms Making No Change to 1996 Base Acres

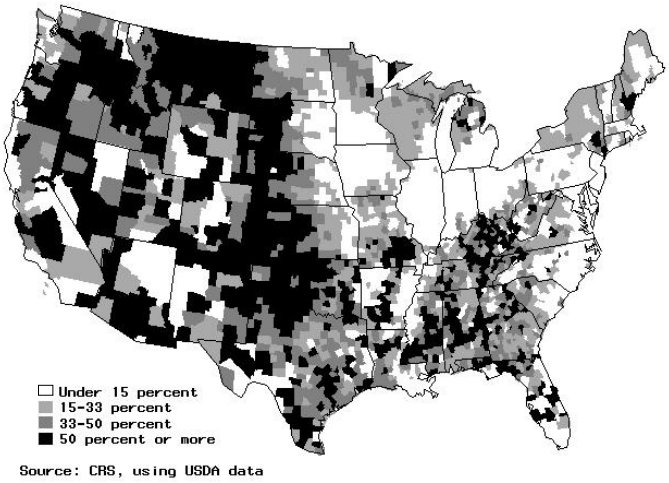


Figure 4. Percent of Farms Adding Oilseeds to 1996 Base Acres

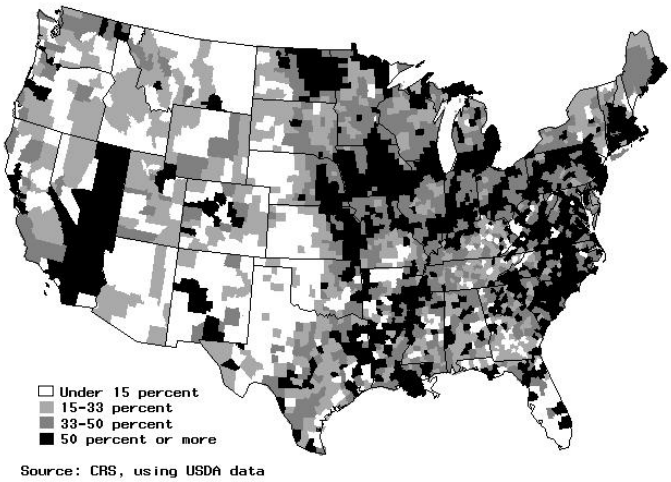
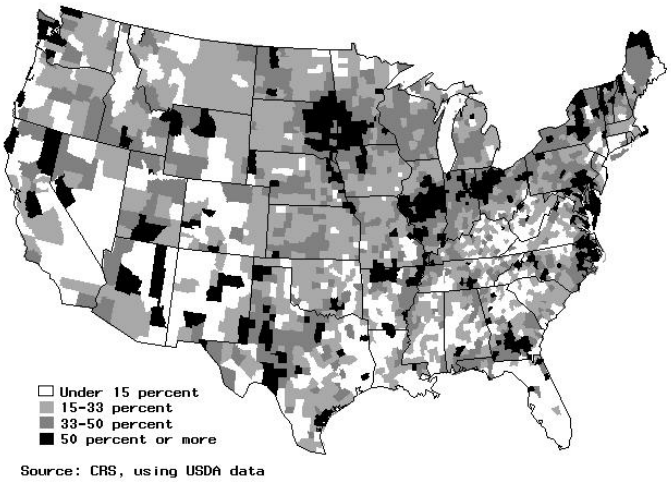


Figure 5. Percent of Farms Updating All Crop Bases Using Planting History



These changes indicate that many farmland owners perceived economic value in adjusting their base acreage and yields. They updated base acres in ways that increased their expected income from program payments. Farmland owners with high-payment base acres, such as rice and cotton, held on to these base acres and, whenever possible, expanded them. Farmland owners with low-payment base acres, such as oats and barley, switched to higher payment commodities whenever possible based on recent planting history or the opportunity to create oilseed base acres.[20]

Classification for International Trade Agreements

The World Trade Organization (WTO) is the principal forum for regulating and negotiating multilateral trade. Under the most recently completed round of WTO trade negotiations — the 1995 Uruguay Round — the United States agreed to abide by a set of disciplines that govern not only export subsidies, import tariffs, and quotas, but also domestic farm programs. Programs with greater potential for stimulating excess production and distorting world trade became subject to annual subsidy limits.

Under the WTO, domestic farm support programs are categorized into boxes (amber, blue, or green) according to their likelihood to distort trade. Amber box policies (the most trade-distorting policies) are subject to total annual spending limits. In contrast, blue box policies are narrowly defined to include only a specific subset of production-limiting programs, but have no spending limit. Finally, green box policies (the least trade-distorting policies) are exempt from spending limits.

The categories provide policymakers latitude to develop domestic support measures that both can benefit producers and at the same time comply with WTO obligations. Countries are largely self-policing when categorizing and reporting subsidies. That is, each country has some discretion in determining whether a subsidy is green or amber, and in calculating the value to report to WTO. Once notified, classifications may be challenged under WTO dispute settlement processes. The United States has yet to notify the WTO concerning any payments made under the 2002 farm bill, leaving some uncertainty as to classifying new payments.

The Administration is expected to classify and report **direct payments** as "decoupled" and place them in the green box where they are exempt from limits. This would be consistent with the classification of production flexibility contract (PFC) payments under the 1996 farm bill. However, this classification was brought into question by a 2005 appellate ruling in a WTO dispute settlement case brought by Brazil against the U.S. cotton program.[21] The case found that U.S. direct payments do not qualify for the green box as fully decoupled income support because of the restriction on planting fruits and vegetables on base acres. However, the panel did

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[20] USDA Economic Research Service, *Economic Analysis of Base Acre and Payment Yield Designations Under the 2002 U.S. Farm Act*, Economic Research Report 12, Sept. 2005, 46 pp. [http://www.ers.usda.gov/publications/err12/err12.pdf].

[21] See CRS Report RL32571, *U.S.-Brazil WTO Cotton Subsidy Dispute*, by Randy Schnepf.

not specifically reclassify U.S. direct payments as amber box, nor did the panel recommend that the United States should notify such future payments as amber box.

Because **counter-cyclical payments** did not start until 2002, the United States has yet to notify them to the WTO. However, the United States has been negotiating in the WTO's Doha Round to redefine blue box criteria to include counter-cyclical payments. Some other WTO members have argued that counter-cyclical payments should be notified in the amber box because they are tied to market prices and have no acreage limitations.

Benefits from the **marketing loan program** such as marketing loan gains and loan deficiency payments are classified as amber box payments because they are linked to per-unit levels of production.

For a detailed discussion of the WTO and U.S. agricultural policy commitments, see CRS Report RL30612, *Agriculture in the WTO: Member Spending on Domestic Support*, and CRS Report RS20840, *Agriculture in the WTO: Limits on Domestic Support*, both by Randy Schnepf.

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 occur primarily over FY2003-08. USDA and the Congressional Budget Office (CBO) periodically estimate a baseline for agricultural programs, using projections of production, inventories, and prices.

Projections of spending in future years are only estimates, and actual amounts can vary greatly from the forecasts. The commodity programs are mandatory programs authorized by the farm bill, not discretionary programs subject to annual appropriations. Payments will be made on prevailing conditions, regardless of budget projections. When actual spending is less than the forecast, no budgetary savings are realized. When actual spending is greater than the forecast, no penalty on future or other program spending is assessed nor is any supplemental appropriation necessary.

Table 9 shows USDA data for the actual spending in FY2003-05 and estimated spending in FY2006-08 for commodities receiving direct payments, counter-cyclical payments, and marketing loans as described in this report. Total payments for these commodities under the 2002 farm bill range from $6.7 billion in FY2004 to an estimated $14.4 billion in FY2006.[22] These amounts do not include any disaster, emergency, or market-loss payments made by supplemental appropriations bills.

[22] For the latest estimate of commodity program spending, including dairy payments, market loss assistance, and certain conservation spending, see USDA's "Table 35 — CCC Net Outlays by Commodity and Function" at [http://www.fsa.usda.gov/dam/bud/bud1.htm].

Table 9. 2002 Farm Bill Payments By Type and Commodity

(Millions of dollars)

Covered commodities and loan commodities	Fiscal year					
	2003 actual	2004 actual	2005 actual	2006 est.	2007 est.	2008 est.
By type of payment	Millions of dollars					
Direct payment*	$4,151	$5,289	$5,234	$4,800	$4,322	$5,256
Counter-cyclical pmt.	1,743	809	2,772	4,291	5,109	3,560
Loan deficiency payment	693	461	3,856	4,839	4,258	2,954
Marketing loan gains**	190	114	318	477	295	56
Total	**6,777**	**6,673**	**12,180**	**14,407**	**13,984**	**11,826**
By commodity	Millions of dollars					
Corn	$1,432	$2,588	$6,104	$9,224	$7,192	$5,474
Other feed grains	204	344	566	708	512	482
Wheat	851	1,210	1,186	1,152	1,706	2,009
Cotton	1,953	872	2,423	1,982	1,931	1,423
Rice	1,058	829	531	523	457	509
Peanuts	307	169	265	227	237	198
Soybeans	905	606	1,035	448	1,806	1,599
Minor oilseeds	35	24	28	50	37	23
Wool, mohair, honey	19	12	8	38	43	47
Lentils, chickpeas, dry peas	13	19	34	55	63	62
Total	**6,777**	**6,673**	**12,180**	**14,407**	**13,984**	**11,826**

Source: CRS, using USDA Farm Service Agency, "Output 50: Total Cash Commodity Payments," and "Output 4: Summary of CCC Loan and Inventory Activity," *Commodity Estimates Book for FY2007 President's Budget* (Feb. 6, 2006).

* USDA estimates smaller direct payments in *fiscal years* 2006-07 due to the Deficit Reduction Act of 2005 which cuts advance direct payments. Total direct payments per *crop year* will remain nearly constant at approximately $5.2 billion.

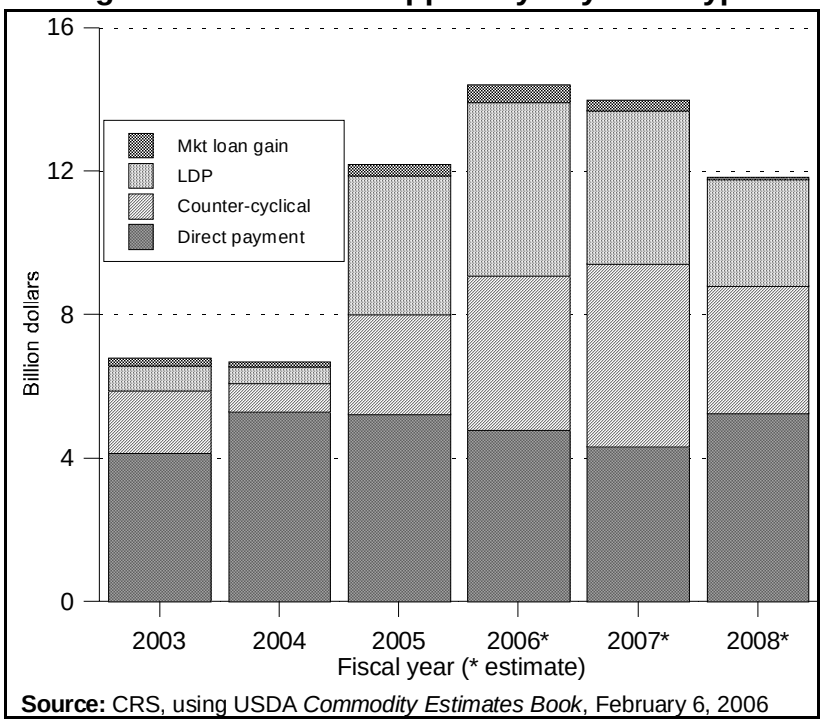
** Includes certificate gains.

Direct payments per *crop year* are nearly constant at $5.2 billion annually. However, due to cuts in the advance payment ratio contained in the Deficit Reduction Act of 2005, USDA estimates smaller direct payments in *fiscal years* 2006-07 (**Figure 6**). The cut pushes some crop year 2006-07 payments into FY2007-08. However, USDA's estimates do not reflect CBO's score that FY2006 savings will not be achieved since the act was enacted *after* advance payments for crop year 2006 were made (see the Timing of Payments section). Thus, a more accurate projection of direct payments may be about $5.2 billion in FY2006 and $3.8 billion in FY2007.

Because counter-cyclical payments and marketing loans depend on market prices, they can vary over time. Counter-cyclical payments range from less than $1 billion in FY2004 to an estimated $5.1 billion in FY2007. The vast majority of marketing loan benefits are paid out as loan deficiency payments (rather than actually

taking out a loan). LDP's range from $0.5 billion in FY2004 to an estimated $4.8 billion in FY2006 (**Figure 6**).

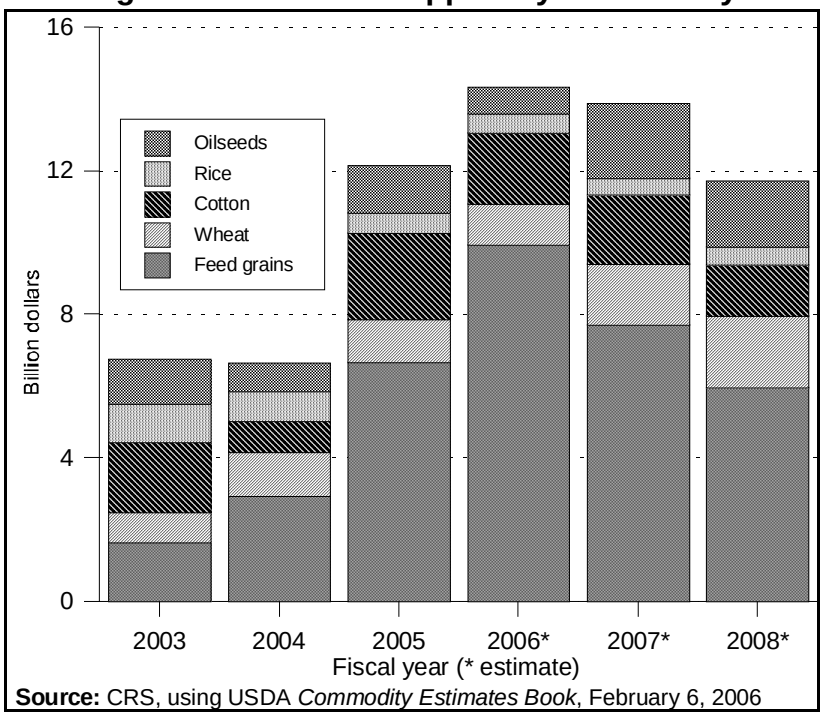
Figure 6. Farm Bill Support by Payment Type



Source: CRS, using USDA *Commodity Estimates Book*, February 6, 2006

By commodity, feed grains (primarily corn) clearly receive most of the support, followed more distantly by cotton, wheat, oilseeds (primarily soybeans), and rice (**Figure 7**). This ranking by total dollars depends on acreage allocations, market prices relative to target prices, and subsidies per acre. Different rankings may result using criteria such as subsidy per acre or subsidy per farm (see CRS Report RL32590, *Average Farm Subsidy Payments, by State, 2002*, by Jasper Womach).

Figure 7. Farm Bill Support by Commodity



Source: CRS, using USDA *Commodity Estimates Book*, February 6, 2006

In conclusion, government policy provides a safety net for farm income by providing income support through direct, counter-cyclical, and marketing loan payments. These policies, however, may contribute to world trade and production distortions, raise land prices and costs of production, and concentrate benefits among certain commodities and producers. This report summarized how those payments are made, and provided examples and data. For information about current policy issues affecting the commodity programs or issues affecting the next farm bill reauthorization, please see the CRS reports listed below.

Additional Information

CRS Reports

CRS Report RS21999, *Farm Commodity Policy: Programs and Issues for Congress*, by Jim Monke.

CRS Report RS21493, *Payment Limits for Farm Commodity Programs*, by Jim Monke.

CRS Report RL32590, *Average Farm Subsidy Payments, by State, 2002*, by Jasper Womach

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