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Farm "Counter-Cyclical Assistance"

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Summary

Congress has approved legislation (P.L. 107-171) reauthorizing major farm income and commodity price support programs through crop year 2007. This legislation includes new "counter-cyclical assistance" programs for grains, cotton, oilseeds, peanuts, and milk. The intent of counter-cyclical assistance is to provide more government support when farm prices and/or incomes decline, and less support when they improve. In fact, farmers have, for many years, been eligible for various forms of counter-cyclical assistance. At issue has been the need for, and potential impacts of, another counter-cyclical program. This report will not be updated.

Background

Farming often is characterized as a "cyclical" business with exaggerated price swings that are destabilizing. Farmers respond to high prices by boosting output. However, when prices drop, farmers are not quick to cut back production. They are more likely to operate at a loss and draw down resources. Contributing to the unstable nature of the farm economy are the weather, export demand, currency exchange rate fluctuations, and the farm support and export subsidy programs of foreign competitors.

Typically, farmers do not view the eventual self-correcting character of commodity prices and production with the same equanimity as economists. In fact, U.S. producers of the major crops have asked for and received federal intervention – including various forms of counter-cyclical assistance – to support their commodity prices and incomes for nearly the past 70 years.

Between 1973 and 1995, a prominent form of counter-cyclical aid was deficiency payments linked to target prices. Congress specified, for each major crop, an annual per-unit target price (e.g., $4 per bushel for wheat). If, as often occurred, the market price was below the target price, eligible producers received a deficiency payment to make up the difference. This aid was ended by the Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (P.L. 104-127).

Provisions of the 1996 Law

Under Title I of the 1996 Act, fixed production flexibility contract (PFC) payments replaced target price deficiency payments. These payments were intended to provide, over 7 years, a total of about $36 billion to eligible producers or landowners. The PFC payments were not linked to either current production or prices. By design, lawmakers intended that these fixed payments, along with the ability to make unconstrained planting decisions, would cause the marketplace rather than subsidies to guide farmers' production choices.

However, the 1996 law did continue another form of counter-cyclical support: marketing assistance loans. Producers could (and, under the new 2002 law, continue to) pledge their stored grain, cotton, or oilseeds as collateral for a U.S. Department of Agriculture (USDA) nonrecourse commodity loan after harvest. These loans are based on a per-unit (bushel, pound) rate.

In earlier years, these nonrecourse loans were set higher than market prices in order to support farm incomes, and farmers forfeited the commodities pledged as collateral at the end of the loan term (about 9 months). Under the more recent design, farmers can repay the nonrecourse "marketing assistance loans" at less than the original loan rate when market prices are lower than that loan rate. The difference between the USDA loan rate and the lower repayment rate (times the number of bushels under loan) constitutes the federal subsidy. In addition, those producers who choose not take out USDA commodity loans can instead receive the equivalent subsidy as a direct payment, called a "loan deficiency payment" (LDP). The federal subsidy (either a loan gain or LDP) increases as market prices drop below the loan rate, and the subsidy diminishes as prices rise – thus, the "counter-cyclical" nature of the marketing loan program.

When the 1996 farm bill was passed, commodity prices were relatively high, and policymakers widely anticipated that the PFC payments, when combined with whatever was earned from the market, would provide sufficient income to producers. Marketing loans were set at relatively low rates so that they only would be needed as a safety net if prices declined relatively steeply. However, by the late 1990s, major commodity prices declined even more than expected, and generally did not recover to what farmers regarded as acceptable levels. As a result, they relied heavily on marketing loan benefits, which went from zero in FY1996, to a high of over $8 billion in FY2000 (the cost has declined somewhat since then).

Congress determined that the "safety net" provided by the 1996 FAIR Act (i.e., marketing assistance loans and fixed PFC payments) was inadequate, and supplemented the benefits with additional, emergency "market loss payments." These payments, mainly to PFC enrollees, added about $3 billion in FY1999, $11 billion in FY2000, and $5.5 billion in FY2001 to program costs. These supplemental payments also can be characterized as counter-cyclical – even though they are *ad hoc* and not "programmed" into standing law – because they were made (according to the sponsors) in response to low prices and incomes.

The New Counter-Cyclical Programs

Nearly all of the numerous farm and commodity organizations that testified before the House and Senate Agriculture Committees in 2001 requested that additional counter-cyclical support be developed as a supplement to the current marketing assistance loans and fixed annual payments. In response, the separate farm bills passed in October 2001 by the House and February 2002 by the Senate, incorporated new counter-cyclical measures into standing law. Thus, Congress presumably would no longer have to debate and enact periodic emergency *ad hoc* assistance.

The final farm bill, the Farm Security and Rural Investment Act (FSRIA) of 2002 (H.R. 2646, P.L. 107-171), provides new long-term counter-cyclical support for grains and cotton, by restoring target prices and deficiency payments, similar in some respects to the program terminated by the 1996 Act. What are now called annual PFC payments are replaced with fixed, “direct payments” to farmers. Both types of payments will be available to producers with annual agreements with USDA. In addition, the measure maintains marketing assistance loans and loan deficiency payments as they now function, with changes in most loan rates.

The new law, which covers the 2002-2007 crop years, brings soybeans and the minor oilseeds (e.g., sunflowers, etc.) fully under the support program rules that apply to grains and cotton. In a major departure from the past, FSRIA redesigns peanut support to operate like that for grains, oilseeds, and cotton – instead of the traditional system of peanut marketing quotas and nonrecourse price support loans.

Under the new law, fixed payments and target price deficiency payments will be paid on 85% of each farm’s base production (base acres times base yield of each commodity). A farmer may choose, as base production, either the acreage used for PFC payments, or average acres planted to eligible crops from 1998 through 2001. Yields effectively are the 1981-85 averages, except that, for counter-cyclical payments, yields also can be updated under a statutorily-prescribed formula.

A key difference between the new target price payments and those made until 1995, is that the old payments were tied to annual planting rules (i.e., an acreage reduction program.) The new system is not contingent upon such rules: payments are based upon historical, not current, production, and farmers can plant virtually any crops except most fruits and vegetables.

Under the new counter-cyclical program, the deficiency payment rate will be calculated as the difference between the target price, and the lower average season market price (but not to exceed the difference between the target price and the sum of the loan rate and fixed payment). (See Table 1 for rates). An individual may receive no more than $130,000 per year in counter-cyclical assistance.

Milk support would continue under FSRIA through government purchases of nonfat dry milk, butter, and cheese. However, it has an added feature of counter-cyclical payments. Dairy farmers nationwide will be eligible for "national dairy market loss payments” whenever the minimum monthly market price for farm milk used for fluid consumption in Boston falls below $16.94 per hundredweight (cwt.). In order to receive a payment, a dairy farmer must enter into a contract with the Secretary of Agriculture. The value of the payment equals 45% of the difference between the $16.94 per cwt. target price in any month that the Boston market price falls below $16.94. A producer can receive a payment on all milk production during that month, but no payments will be made on any annual production in excess of 2.4 million pounds per dairy operation. All contracts expire on September 30, 2005. (See *Dairy Farmer Counter-Cyclical Assistance* in the CRS electronic briefing book on *Agriculture Policy and the Farm Bill*.)

Table 1. Loan Rates, Fixed Payment Rates, and Target Prices

Crop	Loan Rates		Fixed Payment Rates		Counter-Cyclical Target Prices	
	Prior Law (2002 level)	2002 Law (2002/03, 2004/07) *	Prior Law (2002 level)	2002 Law	Prior Law (1995 level; NA 1996-2002)	2002 Law (2002/03, 2004/07) *
Wheat, $/bu	2.58	2.80, 2.75	0.46	0.52	4.00	3.86, 3.92
Corn, $/bu	1.89	1.98, 1.95	0.26	0.28	2.75	2.60, 2.63
Sorghum, $/bu	1.71	1.98, 1.95	0.31	0.35	2.61	2.54, 2.57
Barley, $/bu	1.65	1.88, 1.85	0.19	0.24	2.36	2.21, 2.24
Oats, $/bu	1.21	1.35, 1.33	0.021	0.024	1.45	1.40, 1.44
Cotton, $/lb	0.5192	0.52, 0.52	0.0554	0.0667	0.729	0.724, 0.724
Rice, $/cwt	6.50	6.50, 6.50	2.050	2.35	10.71	10.50, 10.50
Soybeans, $/bu	5.26	5.00, 5.00	NA	0.44	None	5.80, 5.80
Oilseeds, minor, $/lb	0.093	0.096, 0.093	NA	0.008	None	0.098, 0.101

* *Reflects rates that change in some years. NA=not applicable.*

Whereas the final farm bill ties the availability of counter-cyclical assistance to target prices for specified commodities, other designs also were discussed. For example:

- One plan would have triggered payments in a state whenever state (as opposed to national) gross cash receipts for any of eight program or oilseed crops are forecast for the year to be less than 94% of that state's annual average cash receipts for the crop during 1996-1999. Cash receipts would be defined as the national average price times state-level production. Those who produced the crop during 1998-2000 would be eligible for a share of total payments (American Farm Bureau Federation).

- Another would have established a "national target income" for each major crop: that is, the national average annual market value of the crop during 1996-2000, plus the annual average of any marketing loan benefits and market loss assistance payments made during those years. A further adjustment would be made to account for yield increases since then. Those who produced that crop during 1996-2000 would be eligible for a share of total payments whenever returns (defined as the crop's U.S.

production times the average price for the first 3 months of the marketing year) are below the national target income for the crop (National Corn Growers Association).

Cost

The Congressional Budget Office (CBO) has estimated the commodity support provisions (Title I) of FSRIA at $98.9 billion over 6 years (budget authority, March 2002 estimate, FY2002-2007). This is $37.6 billion more than the baseline policy of simply extending current programs into the future. The new counter-cyclical payments for grains, cotton, and oilseeds account for $23.6 billion of the new costs (i.e., above baseline). The peanut and dairy counter-cyclical payments are projected to cost, respectively, another $904 million and $963 million.

However, such cost estimates are speculative due to the extreme difficulty of predicting future market conditions, including prices. If prices are lower than CBO's assumptions, then costs will be higher, and vice versa. Some other analysts already have differing projections.

For example, the Food and Agricultural Policy Research Institute (FAPRI) at the University of Missouri estimates that the total cost of the dairy program alone could exceed $3.6 billion. That's mainly because FAPRI projects significantly lower market prices for milk than CBO over the 46-month life of the program. CBO estimates that the average monthly payment rate over the 46-month life of the program will be about $0.45 per cwt.; FAPRI estimates an average monthly payment rate of $0.89 per cwt.

(See also What Is the Cost of the 2002 Farm Bill? in the CRS electronic briefing book on *Agriculture Policy and the Farm Bill*.)

International Trade Obligations

The 1994 Uruguay Round Agreement on Agriculture (URAA) obligates countries to discipline their agricultural subsidy programs and reduce import barriers in order to promote more open trade. Under the URAA, the United States is committed to providing subsidies of no more than $19.1 billion per year through domestic farm policies with the most potential to distort production and trade.

The URAA contains detailed rules for how countries should determine which of their programs must be counted toward their assigned subsidy limits (e.g., $19.1 billion for the United States). Generally, however, programs that are tied to current prices or current production must be counted (these are called "amber box" policies). Thus, marketing loan gains, which rise when crop prices decline and vice versa, are "amber" and must be counted (but only if their value, along with other subsidies, exceeds 5% of the value of annual production of that crop).

On the other hand, subsidies that are not linked to prices or production, and/or meet other specified criteria, might be exempted as "green box" policies. The United States has classified its PFC payments as "green" because they are made without regard to prices or current production. It is anticipated the fixed, decoupled payments in the new law also will fall within the green box.

The new counter-cyclical assistance will be decoupled from current *output* because the producer would not have to produce any particular crop now to receive the payments. However, because (like marketing loan gains) the target price deficiency payments would be triggered by current market *prices*, they are expected to be placed in the amber box. So, they conclude, if counter-cyclical payments, when added to other "amber" subsidies such as marketing loan benefits, caused U.S. spending to exceed $19.1 billion, the United States could be in violation of its world trade commitments. Whether that would happen is unclear, in part because of the difficulty of predicting future market prices, but also because of the technicalities involved in classifying and valuing subsidies under the WTO system.

"Circuit breaker" language in FSRIA is intended to require USDA to keep trade-distorting farm subsidies at or below the $19.1 billion limit. Questions arise about the administrative, economic, and political implications of changing (i.e., reducing) benefits, particularly after they are announced and/or awarded. (See CRS Report RL30612, *Farm Support Programs and World Trade Commitments*.)

Some groups had argued that their own counter-cyclical policies could be designed in a way that they would not have to be counted toward the $19.1 billion limit. For example, if payments to farmers were triggered by low income (as measured by gross receipts for one or more commodities) rather than by low prices, they would be exempt, it has been argued. Others dispute this assertion, noting that it is usually low prices that cause low income.

Equity Issues

The new counter-cyclical aid in the 2002 law focuses on the "major" commodities – grains, cotton, oilseeds, peanuts, and milk. These generally are the most widely produced, but that still leaves much of U.S. agriculture ineligible for such payments, raising questions of equity among commodities, and of the potential for distorting production toward items that might receive more support (contributing to surplus production). But extending such aid to more commodities, such as fruits, vegetables, or livestock, also would have increased federal costs, or else reduced assistance levels for the major commodities. Also, not all commodity groups sought such aid. For example, the National Cattlemen's Beef Association was among those that opposed most forms of direct assistance, counter-cyclical or otherwise. And, the United Fresh Fruit and Vegetable Association argued against any subsidies that would insulate fruit or vegetable producers from market signals or would sustain or encourage production.

Another issue was whether a new counter-cyclical program should perpetuate past patterns that tie aid to output rather than economic need. Farm programs, including direct payments, marketing loans and the *ad hoc* "market loss payments," have been based on either past or current production by individual farmers, meaning that larger payments have trended toward larger operations – which do not or should not need them, critics argue. They add that if Congress intends to help producers in economic distress, then such recipients should have to document their need. Others counter that farm programs are not "welfare" but rather part of a larger policy to ensure that U.S. agriculture remains competitive in the global economy (an assertion that critics challenge).