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Overview of the 2007 USDA Farm Bill Proposals for Commodities

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The Commodity Title of the Administration's (USDA) Farm Bill proposal includes a number of specific policy recommendations for crop agriculture. In many respects, the Administration's proposals retain much of the spirit of the 2002 Farm Bill for commodity programs. In particular, the Administration recommends keeping the current structure of payments that includes direct payments, counter-cyclical payments, and marketing loan/loan deficiency payments. However, the Administration recommends some changes to each of those programs.

The following discussion summarizes the Administration's suggested changes to the primary commodity programs as well as other changes in the areas of payment limitations; fruit and vegetable planting restrictions; and land exchanges involving Section 1031 of the Internal Revenue Code.

Direct Payments

The Administration recommends increasing the direct payments to producers from current levels. The current and proposed direct payment rates are summarized in Table 1.

The Administration's proposals for counter-cyclical and marketing loan programs will detrimentally affect some commodities, particularly cotton. Consequently, they are proposing increases in the direct payments for these commodities. Barley, soybeans, and cotton would see a direct payment increase in all years of the Administration's proposal, while all other commodities including wheat and corn would only see an increase in the three years between 2010 and 2012. Cotton, because of its least favorable treatment in other parts of the Administration's proposals, would see a 67% increase in direct payments. This is more than a 12-fold increase

Table 1. Current and Proposed Direct Payment Rates

Crop	Current Program	Administration's Proposal	
		2008-2009	2010-2012
Corn ($/bu)	0.28	0.28	0.30
Sorghum ($/bu)	0.35	0.35	0.37
Barley ($/bu)	0.24	0.25	0.26
Oats ($/bu)	0.02	0.02	0.03
Wheat ($/bu)	0.52	0.52	0.56
Soybeans ($/bu)	0.44	0.47	0.50
Rice ($/cwt)	2.35	2.35	2.52
Upland Cotton (cents/lb)	6.67	11.08	11.08
Peanuts ($/ton)	36.00	36.00	38.61
Other Oilseeds ($/cwt)	0.80	0.80	0.857

over the increase in corn direct payments per acre ($26/acre increase for cotton versus a $2.05/acre increase for corn in only years 2010-2012). The Administration proposes an additional 20% increase in direct payments to beginning farmers. The total budget for direct payments under the proposal increases from $5.25 billion per year to $5.8 billion per year.

The Administration cites the general favored nature of these payments by our trading partners as the primary reason for increased funding in this area. Although negotiations are stalled in the current Doha round of the World Trade Organization, the Administration believes that a move to more "decoupled" payments such as direct payments will be viewed favorably by countries engaged in the WTO negotiations.

The increase in direct payments for beginning farmers is an attempt by the Administration to entice young people into farming. This program addition is expected to add approximately $0.25 billion per year to this program's cost.

Comment

This proposal raises several questions, including the following.

- Will the individual commodity groups complain loudly about the differential treatment with respect to increases in the direct payment?
- How will "beginning farmers" be defined? Is this for anyone that begins at any level in farming? Will it target only those beginning in farming at a commercial level? Must you own farmland or other assets to be a beginning farmer? Does it include the son or daughter coming back to the farm that has no specific ownership stake? How will multi-generation farms be handled?
- Will the increase in direct payments entice some landowners in marginal production areas to stop producing and simply collect the direct payment?
- How much will the increase in direct payments increase land values, if at all? Past analyses have suggested that direct payments, because of their transparent easy to calculate nature, are almost immediately capitalized into land values and land rents.

Counter-Cyclical Payments

The Administration recommends replacing the current price-based counter-cyclical payment program for each commodity with revenue-based counter-cyclical payments for each commodity. The revenue-based payment would be triggered when the actual national revenue per acre is less than the national target revenue per acre.

The target price for each commodity would remain the same as specified in the 2002 Farm Bill. The key difference is that rather than making payments based on the difference between the target price and the market price, payments would be based on the difference between the established national average revenue target and the actual national average revenue. A summary of the calculation used to determine the counter-cyclical payments is contained in the text box on page 3 for those interested in the details of this program. This proposed change in the counter-cyclical program is expected to save $0.37 Billion per year over the current version of the counter cyclical program.

Comment

The intent of the changes in the counter-cyclical program is to have payments better reflect the "need" of the program participants rather than making payments when high yields might more than offset lower prices. Under current rules, producers could receive payments under the counter-cyclical program even though their yields were well above typical levels, and these increased yields would reduce the "need" for government payments. Changing the counter-cyclical program in this way is a move towards a revenue assurance program that has been proposed by several groups, including the National Corn Growers Association, the American Farmland Trust, and some state Farm Bureaus.

One key question in this program change is the timing of payments. The national average yield for the year is usually not known until well after the harvest season. Payments will be delayed substantially if yields must be finalized before payments are made. Under the current counter-cyclical payment system, early payments are made based on expected market prices. Perhaps under the proposed system, a similar early payment mechanism could be implemented but that is not clear from the Administration's proposal.

Proposed Revenue Based Counter-Cyclical Payments

The following steps summarize how the payments would be calculated, using corn as the example.

1. Subtract the Direct Payment Rate from the Target Price to determine the price guarantee.

   $2.63 - $0.28 = $2.35.

2. Determine the historical national average yield by computing the Olympic (drop the high and the low) five-year national average yield for the commodity. In the example below, '02 and '04 yields would be dropped.

Calculation of Olympic Average for Corn Yields

2002	2003	2004	2005	2006	Olympic Average
129.33	142.21	160.35	147.95	147.29	145.82

3. Compute the Target Revenue for the year.

   $2.35 * 145.82 = $343/acre

4. Compute the actual revenue for the year based on the national season average price received and the national average yield as determined by the National Agricultural Statistics Service.

   As an example, if the season average price of corn is $2.20 and the national average yield is 155 bushels, the national average revenue would be $341 per acre.

5. Compute the revenue payment per acre.

   $343 - $341 = $2/acre

6. Divide the revenue payment per acre by the national average counter-cyclical program yield, determined under the 2002 farm bill, to determine the counter-cyclical payment per bushel.

   $2 acre divided by 114.3 = $0.017 per program bushel.

7. Multiply the computed revenue payment per bushel by the counter-cyclical payment per bushel for the individual farm payment.

   $0.017 * 100 ac. base * 115 bu. program yield * 0.85 = $167.

   Under the 2002 program the payment would have been:

   $0.15 * 100 ac. Base * 115 bu. program yield * 0.85 = $1,466.

Marketing Loan/Loan Deficiency Program

The Administration proposes to change the current ML/LD program by having loan rates determined based on 85% of the 5-year Olympic average of historical prices for each commodity covered under the program. The actual loan rate would be the lower of the 5-year Olympic average determined loan rate or the loan rate levels established under the 2002 Farm Bill. Table 2 summarizes the differences between current loan rates and the average loan rates expected under the Administration's proposal. Corn, for example, would have a maximum national average loan rate level of $1.89/bu (the official loan rate set in 2002), which is $0.06/bu. lower than current national average loan rate level. Given the strong demand for corn-based ethanol, with corn prices well above $3.00 per bushel, it is unlikely that 85% of the 5-year moving average will result in a loan rate less than $1.89 per bushel in the foreseeable future. The same is not true for commodities such as cotton and peanuts that are likely to see loan rates below the cap and quite a bit below their current loan levels.

The Administration also proposes replacing the daily posted county price (PCP) with a monthly average posted county price. This repayment price is used to determine the rate at which a producer would repay his/her commodity loan or to determine the per unit payment the producer would receive in lieu of taking out a commodity loan—the loan deficiency payment (LD). In addition to the change in the way the PCP would be calculated, a producer's LD rate would be determined on the day the producer lost "beneficial interest" in the crop (i.e., sold the crop). Under current rules, producers do not have to wait until the crop is sold to determine their LD rate. This change would be for all crops currently covered by the marketing loan program except for cotton and rice.

Table 2. Current and Proposed Loan Rates

Crop	Current Loan Rates	Average Loan Rates from 2008-2012 under the Administration's Proposal
Corn ($/bu)	1.95	1.89
Sorghum ($/bu)	1.95	1.89
Barley ($/bu)	1.85	1.70
Oats ($/bu)	1.33	1.21
Wheat ($/bu)	2.75	2.58
Soybeans ($/bu)	5.80	4.92
Rice ($/cwt)	6.50	6.50
Upland Cotton (cents/lb)	51.92	45.70
Peanuts ($/ton)	355.00	336.00
Other Oilseeds ($/cwt)	9.30	0.087

Comment

The main impact of this recommended change is to eliminate the possibility of the producer being able to "cherry pick" the best price period to exercise their marketing loan repayment or loan deficiency payment. Currently, producers can pick the day to price their crop for loan deficiency purposes as long as they have not lost beneficial interest. In fact, they can "exercise" their LD payment and continue to own their grain to sell at another time, perhaps when prices are higher. With a monthly average posted county price and the requirement that beneficial interest must be lost to determine the LD rate, this "cherry picking" approach to the program would be eliminated.

Under the current program, farmers have been able to maximize the gains from the loan deficiency program while also improving their prices from the market by storing or forward pricing their crop. This proposed change would make it necessary for farmers to reevaluate their marketing plans since the ability to maximize the loan deficiency gains will be directly tied to the decision to sell the crop. While this change reduces the producer benefits from the current program, it likely better aligns the mechanics of the program with its intent, which is to provide a floor on the price of the commodity and thus a safety net for farmers' incomes (not to create an opportunity to gain profit on market swings).

Payment Limitations

The Administration proposes a number of changes to the payment limitations in the Farm Bill. The overall payment limit of $360,000 is unchanged, but the limit for direct payments would increase from $80,000 to $110,000 to accommodate the proposed increase in direct payments. The counter-cyclical payment cap would be reduced from $130,000 to $110,000, and the marketing loan or LD cap would be reduced from $150,000 to $140,000.

In addition to the change in payment caps for each payment type, the Administration also proposes replacing the "three entity" rule with direct attribution of payments to individuals. Thus, the $360,000 USDA payment limit would be the limit for any individual person and/or legal entity that can prove active engagement in farming. The new rule could make it more difficult to use multiple entities to obtain a higher payment limit, as is possible under the current law.

The Administration also proposes making any person or entity with an adjusted gross income (AGI) above $200,000 ineligible for farm commodity payments. This AGI eligibility cap is reduced from the current AGI cap of $2.5 million. The original $2.5 million cap would remain when determining eligibility for conservation title payments. This reduction in the AGI cap is substantial. The Administration estimates that only 3.6% of farms in 2003 would have been subject to the $200,000 limit. However, current crop price levels would likely increase that percentage. In contrast, a recent simulation analysis conducted by the Agricultural and Food Policy Center at Texas A&M University indicated that 17 of their 19 representative grain farms would face the AGI cap at least one year over the next 10 years.

Comment

Payment limitations will be a hotly debated item as Congress moves to pass a 2007 Farm Bill. The current payment limits potentially affect producers of the heavily subsidized commodities such as rice and cotton the most. Thus, the political debate tends to be South versus North rather than Republicans versus Democrats. The debate over the Administration's proposal will be much the same.

There are several questions that these payment limitation proposals raise.

- What are the implications of eliminating the "three entity" rule?
- How will the limits be administered and monitored?
- Will it be easier or more difficult to track payments to an individual?
- Does the Farm Service Agency have the staff and budget to police the payment limit rules effectively at the local level?
- How might the corn/soybean farms of the Midwest be affected by the new AGI limits and will that shift regional perspectives in this debate?

Other Changes

The Administration proposes additional changes to the Farm Bill that will have direct implications for the commodity programs. Below is a brief synopsis of those changes.

1031 Exchange

Farmland acquired under the like-kind exchange (1031) rules of the federal tax code would become ineligible for commodity payments. The intent of this change is to reduce the current distortion of farmland prices by a special provision in the tax code. Many believe that the 1031 exchange of property (allowing individuals to avoid capital gains taxes if they reinvest their proceeds in like-kind property) is artificially raising the price of land.

The Administration's proposal is an attempt to discourage individuals from purchasing farmland in a 1031 exchange. If effective, this rule could marginally reduce the pressure on land prices. However, for land owners wanting to sell their land, this provision would reduce the number of potential buyers in the marketplace and marginally limit the potential gains from selling the land.

Planting Flexibility

The Administration proposes eliminating the restrictions on planting fruits and vegetables on land that is currently receiving any government commodity payment. This restriction on planting flexibility has been challenged by the WTO as being illegal under current trade agreements.

In addition, the restriction has been particularly restrictive in the Midwest, where soybean land that used to be "free" to be planted in fruits and vegetables became restricted when that land received a base and government payments starting with the 2002 Farm Bill. Companies positioned to acquire their fruits and vegetables from Midwest farms suddenly found it much more expensive to acquire their raw products because they had to provide additional compensation to growers who would lose their government payments if they produced fruits or vegetables rather than program crops. The Administration's proposal relieves that pressure by eliminating the planting restriction so that producers could receive government payments on program acres even if they choose to grow fruits or vegetables on those acres.

Fruit and vegetable growers in the traditional growing areas of California, Arizona, Texas, and Florida would now be at a perceived disadvantage to Midwest producers that are producing competing products on subsidized land. To compensate for this, the Administration is proposing increased funding for market development and research for fruits and vegetables, and much of the money would be directed to those states with the most affected producers. A recent study by the Economic Research Service casts doubt on the extent to which farmers giving up production of current commodities would then take up specialty crop production.

Final Comments

The Farm Bill debate is under way, and the Administration has tabled their proposal. It is not a dramatic reversal or new direction in farm policy, but does include modest changes to make farm programs more WTO compliant; to target the payments to smaller and mid-size farms and beginning farmers; to provide payments in times of low revenues (price times yield) rather than just low prices; and to provide additional flexibility in the production of fruits and vegetables on base acres. These proposals, although modest in scope, have already and will continue to stimulate substantial debate and discussion.

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