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Payment Limits for Farm Commodity Programs: Issues and Proposals

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Summary

Greater public awareness of sizeable commodity program payments reaching a comparatively small number of very large farms and federal budget constraints have focused the attention of Congress on payment limits. The policy issue is mostly about farm size rather than the financial need of recipients, although the two may be related. Limits on commodity program payments have been imposed since 1970. The 2002 farm bill retains the former limits, adds limits for the new counter-cyclical program, and incorporates new commodities. It also continues to permit the use of commodity certificates to avoid the marketing loan limit.

In the 108th Congress, the Senate-passed version of the FY2004 budget resolution (S.Con.Res. 23) contains a much-publicized amendment by Senator Grassley regarding payment limits. Senator Grassley also introduced a bill (S. 667) to reduce direct and counter-cyclical payment limits and count commodity certificates toward the marketing loan limit. Translating the dollar limits into crop acreage levels makes it easier to see how farmers might be affected. Lower payment limits most likely would be felt by cotton and rice producers. This report will be updated as events warrant.

Background on Payment Limits

Payment limits restrict the dollar amount of farm program payments a "person" can receive. They have been prescribed in the law since the Agricultural Act of 1970 (P.L. 91-524). The term "person" is defined more broadly than an individual, and can include certain kinds of corporations, partnerships, and trusts.

The policy debate about the need for and level of payment limits continues in the 108th Congress. It is mostly about farm size and the purpose of farm programs. The debate is not about financial needs of recipients, since farmers do not need to demonstrate financial hardship to be eligible for commodity programs. Limits are intended to reduce program expenditures and to address perceived inequities in payment distributions.

Supporters of payment limits use both economic and political arguments. Economically, they contend that large or unlimited payments benefit large farms, facilitate consolidation of farms into larger units, raise the price of land, and put smaller, family-sized farming operations at a competitive disadvantage. They say that smaller limits would reduce financial incentives for farms to expand, and facilitate small and beginning farmers in buying and renting land. Politically, they believe that large payments to large farms undermines public support for farm subsidies and is costly to the federal budget.

Critics of payment limits counter that all farms are in need of support, especially when market prices decline, and that larger farms should not be penalized for the economies of size and efficiencies they have achieved. They say that such payments help U.S. agriculture compete in global markets and that income testing is at odds with federal farm policies directed toward improving U.S. agriculture and its competitiveness.

The effect of payment limits varies greatly across individual producers. Those affected have relatively large land bases and production. Geographic location is also important, with the South and West tending to have more large farms than the Upper Midwest or Northeast, and thus more possibility of being affected by caps. Cotton and rice farms also are more likely to be affected by the current limits because such farms tend to be larger, and the value of program benefits per acre for those crops is relatively high.

Current Payment Limits Under FSRIA

The Farm Security and Rural Investment Act (FSRIA) of 2002, also known as the 2002 farm bill, retains annual limits on selected commodity program payments (P.L. 107-171, sec. 1603). It adds limits for the new counter-cyclical program and incorporates newly eligible commodities. It creates a prohibition on payments to persons or entities with adjusted gross income exceeding $2.5 million (unless 75% or more comes from farming). Table 1 shows the limits under the 1996 FAIR Act, the House- and Senate-passed versions of the 2002 farm bill, the FSRIA as enacted, and the currently-proposed Senate bill S. 667. The next section provides background on commodity payments and how commodity certificates can be used in the marketing loan program.

The FSRIA preserves two mechanisms that enable payment limits to be doubled. One is the “three entity rule.” This allows one person to receive payments on up to three entities, with payment limits on the 2nd and 3rd entities being one-half of what a single entity would receive. The other mechanism is the “spouse rule.” Generally, a husband and wife are treated as one person for payment limit purposes. However, they can request to be treated as separate persons and thereby double the payment limit for the farm. A farmer can use only one of the two mechanisms to double the limit.

While the final 2002 farm bill did not enact the tighter payment limits, revise the three-entity and spouse rules, or count commodity certificates and loan forfeiture toward payment limits as proposed by the Senate, it did create a Commission on the Application of Payment Limitations for Agriculture, chaired by USDA Chief Economist Keith Collins, to investigate payment limits. Although, the commission’s report is due to Congress by May 13, 2003, USDA has indicated that the report will be issued in summer 2003. The commission has solicited written public comments and held private hearings.

Table 1. Limits on Direct Payments, Counter-Cyclical Payments, and Marketing Loans

	104th Congress	2002 Farm Bill, 107th Congress			108th Congress
	FAIR Act P.L. 104-127	House Plan H.R. 2646	Senate Plan S. 1731	2002 FSRIA P.L. 107-171	S. 667 ***
Direct and Counter-Cyclical Programs					
Direct Payments	$40,000 *	$50,000	$75,000	$40,000	$20,000
Counter-Cyclical Payments	N/A	$75,000		$65,000	$30,000
Additional Payments Due to Three Entity Rule / Spouse Allowance	$40,000 *	$125,000	$50,000	$105,000	50,000
Sum of Above Items	*$80,000 **	*$250,000*	*$125,000*	*$210,000*	*$100,000*
Marketing Loan Program					
(1) Marketing Loan Gains and (2) Loan Deficiency Payments	$75,000 *	$150,000	$150,000	$75,000	$87,500
Additional Payments Due to Three Entity Rule / Spouse Allowance	$75,000 *	$150,000	$0	$75,000	$87,500
Sum of Above Items	*$150,000 **	*$300,000*	*$150,000*	*$150,000*	*$175,000*
(3) Commodity Certificates	No limit **	No limit	Counted toward limit	No limit	Counted toward limit
(4) Loan Forfeiture Gains	No limit	No limit	Counted toward limit	No limit	Counted toward limit
Practical Limit on Marketing Loan Program	*No limit*	*No limit*	*$150,000*	*No limit*	*$175,000*
Sum of Direct, Counter-Cyclical, and Marketing Loan Programs					
Total, Not Counting Use of Commodity Certificates or Loan Forfeiture	*$230,000 **	*$550,000*	*$275,000*	*$360,000*	*$275,000*
Practical Limit, Accounting for All Payments Above	*No limit*	*No limit*	*$275,000*	*No limit*	*$275,000*

Notes: While payments for most qualifying commodities are combined toward a single limit, separate payment limits apply to peanuts and other specialty crops in the House Plan, FSRIA, and S. 667. This provides certain producers a higher total potential limit if they grow crops in each of the commodity groupings.
* Emergency farm economic assistance doubled limits under the FAIR Act for direct payments in 2000-2001, and for marketing loans in 1999 to 2001 (P.L. 106-78, sec. 813; P.L. 106-387, sec. 837; P.L. 107-25, sec. 10).
** After the FAIR Act was enacted, P.L. 106-78, sec. 812, allowed commodity certificates to be exempted from payment limits for repaying marketing loans.
*** S. 667 affects payment limits for covered commodities and most loan commodities, but would not change limits for peanuts, wool, mohair, and honey.

Some conservation programs also have annual payment limits. These include the Conservation Reserve Program ($50,000) and the Environmental Quality Improvement Program ($30,000).

Relevant Commodity Payments Under FSRIA

Under FSRIA, farmers receive three types of commodity payments: direct, counter-cyclical, and marketing loan payments. In all cases, subsidy payments are made per unit of production (e.g., $ per bushel). Direct and counter-cyclical payments depend on a farm's historical base acreage and yields. The farmer is not obligated to grow the crop to receive that crop's direct or counter-cyclical payment, and may exercise planting flexibility without losing benefits. Instead payments are tied to each farm's historical base acreage and yields as defined in the commodity program. Even though the counter-cyclical program also factors in market prices, it does not require the farmer to market any particular level of that commodity since it uses historical production records.

The marketing loan program makes payments based on actual production when market prices are below loan prices. It has four mechanisms to provide benefits, two of which are subject to payment limits.

Subject to payment limits:

- Marketing loan gains (MLGs) accrue when commodity loans are repaid at the posted county price (adjusted world price for cotton and rice), and are effective when such prices are less than the loan rate.
- Loan deficiency payments (LDPs) are paid when farmers agree to forgo loans but exercise a direct payment option. This allows farmers to receive loan program benefits, but market their commodity without loan restrictions that may hold grain off the market.

Exempt from payment limits:

- "Commodity certificates" are purchased from the Commodity Credit Corporation (CCC) at the posted county price and are used to repay the loan for less than the loan price. This alternative yields similar results to MLGs. A 1999 law exempted the use of commodity certificates from payment limits (P.L. 106-78, sec. 812).
- Forfeiting the collateral allows the farmer to retain the principal (cash) in return for surrendering the collateral (commodity). The full loan price thus becomes the effective payment. If this counted towards the payment limit, more farmers would repay their loans since more of the commodity could qualify for benefits (MLGs are smaller per unit than the loan price).

In Congress

Senate Budget Resolution. The Senate-passed version of the FY2004 budget resolution (S.Con.Res. 23) contained a much-publicized amendment by Senator Grassley regarding payment limits and the Conservation Security Program. During Budget Committee debate on March 13, 2003, an amendment was incorporated by 14-9 vote to reduce mandatory agriculture spending by $1.4 billion and increase mandatory conservation spending by the same amount. The assumed reduction in farm program spending would come from tighter payment limitations. However, the Senate budget resolution did not contain specific reconciliation instructions and would only shift funds within the total pool of money available to the Agriculture Committee. Thus the Agriculture Committee, which has jurisdiction over both commodity and conservation programs, would not be bound to propose any legislative changes in either program, even if this budget resolution were adopted. The House-passed version (H.Con.Res. 95) initially proposed much deeper cuts in agriculture programs, but did not specify the method. As the House-Senate conference was pending, the House had limited its cuts in agriculture to discretionary spending only, and not beginning until FY2004.

S. 667. On March 19, 2003, Senator Grassley introduced a bill that would reduce payment limits on direct, counter-cyclical, and marketing loan payments. The statutory limit (before doubling) on direct payments would decrease from $40,000 to $20,000; the limit on counter-cyclical payments would decrease from $65,000 to $30,000. While the stated limit on the marketing loan program would rise slightly from $75,000 to $87,500, the effective limit is reduced because commodity certificates and loan forfeiture would be counted toward the limit. This is a key feature of the bill because, as a practical matter, marketing loan payments are not limited under FSRIA since the limit on MLGs and LDPs simply becomes the point at which the farmer shifts to commodity certificates.

Similar limits were proposed in the Senate-passed version of the 2002 farm bill (S. 1731, 107th Congress) by Senators Dorgan and Grassley, but those limits were not accepted by the conference committee. That bill would have limited direct and counter-cyclical payments to a combined $75,000, allowed only a $50,000 spouse benefit, eliminated the three-entity rule and replaced it with direct attribution, limited the marketing loan program to $150,000, and counted commodity certificates and loan forfeiture towards the limit. Thus, the total limit would have been $275,000 also, but with slightly different limits within each program and less generous doubling rules. In March 2003, CBO estimated that adopting such provisions would save $156 million in FY2004, $883 million over 5 years, and $1.654 billion over 2004-13.

In S. 667, the proposed changes to direct and counter-cyclical payment limits would apply to "covered commodities" as a group (wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans and other oilseeds). The changes to the marketing loan program apply to the covered commodities plus certain loan commodities (extra long staple cotton, dry peas, lentils, and small chickpeas). Peanuts, wool, mohair, and honey[1] are not addressed by S. 667, and thus would remain eligible for the higher limits enacted in FSRIA, including unlimited use of commodity certificates and loan forfeiture.

S. 667 would establish a new rule allowing a person with an interest in only a single farming operation to double the payment limits without needing to use the three-entity or spouse rules, both of which would continue. Thus, individual farmers would have another means and find it easier to double the payment limits. Finally, it would establish a $275,000 cap per person for the total payments covered by the rules.

The bill instructs the Secretary of Agriculture to promulgate regulations to assure, in effect, that all commodity program payments made to joint operations, multiple entities, or other financial or management arrangements under the primary control of one person are counted together toward the limits of the individual. The bill allows the Secretary to promulgate such regulations in an expedited manner.

Size of Farms Affected

How large can a farm be before reaching the payment limits? Table 2 gives an idea using a simple example for several crops. The example is hypothetical because it assumes only a single crop is grown on a farm without using planting flexibility or crop rotations. Although farm-level yields are used in practice, the table uses national averages for comparison. Multi-year averages are used for price and yield so that no single year skews

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[1] The peanut support program under FSRIA duplicates the design for covered commodities. Wool, mohair, and honey are eligible only for the marketing loan program. The combination of peanuts, wool, mohair and honey are counted separately with regard to payment limits.

the results. Nonetheless, the table provides a useful comparison for different crops based on payment rates, target prices, and marketing loans. Estimates are based on the limit for a single entity; acreages would double if the 3-entity or spouse rule were used.

For direct payments, the table shows that an average farm could have 2,320 base acres of wheat before reaching the $40,000 limit. A rice farm would reach the limit with only 351 acres. If the maximum counter-cyclical payment were paid (that is, the season average market price is less than the loan rate), a wheat farm would reach the $65,000 limit with 3,631 acres. The rice farm would need 813 acres. Thus, in this scenario, the direct payment limit is more binding than the counter-cyclical payment limit for wheat, corn, soybeans and rice, but the reverse holds for cotton.

For marketing loans, assuming that commodity certificates are not used to avoid payment limits, the $75,000 limit would not be reached until the wheat farm exceeded 4,329 acres, or 3,236 acres for the rice farm. The table shows how cotton and rice farms can reach one or more of the payment limits with fewer acres than wheat, corn, or soybeans. This is especially noticeable since cotton and rice farms tend to be larger, as indicated by the 1997 Agriculture Census. Cotton requires the smallest acreage to reach the marketing loan limit, especially important if certificates become subject to the limit.

Table 2. Size of Farm Needed to Reach Payment Limits Under the 2002 Farm Bill – A Simple Example

Planting a single crop only, and payment limits are not doubled.	**Wheat**	**Corn**	**Soybeans**	**Cotton**	**Rice**
Base acres to reach $40,000 direct payment limit (1 person)	2,320	1,323	2,971	1,176	351
Base acres to reach $65,000 limit with maximum counter-cyclical payment rate (1 person)	3,631	1,771	5,901	928	813
Acres to reach $75,000 LDP based on avg. harvest price and loan rate	4,329	2,347	4,267	1,712	3,236
Data:					
Average acreage per farm (actual planting, allowing multiple crops)	241	162	186	420	336
<u>2002 farm bill</u> Direct payment rate Target price Loan rate	 $0.52/bu. 3.86/bu. 2.80/bu.	 $0.28/bu. 2.60/bu. 1.98/bu.	 $0.44/bu. 5.80/bu. 5.00/bu.	 $0.0667/lb. 0.724/lb. 0.52/lb.	 $ 2.35/cwt. 10.50/cwt. 6.50/cwt.
U.S. average yield/acre, 1998-2001 Payment yield (at 93.5%)	42 bu. 39 bu.	136 bu. 127 bu.	38 bu. 36 bu.	642 lb. 600 lb.	61 cwt. 57 cwt.
Farm harvest price, avg. 1998-2001 Farm season price, avg. 1998-2001	$2.39/bu. 2.63/bu.	$1.75/bu. 1.90/bu.	$4.54/bu. 4.62/bu.	$0.452/lb. 0.462/lb.	$6.12/cwt. 6.17/cwt.

Prices and yields are from USDA, World Agricultural Supply and Demand Estimates. Average acreage from 1997 Agriculture Census. The example assumes a farm grows only a single commodity and does not use the three-entity or spouse rules to double payment limits. Planting flexibility which, for example, allows a wheat farm to receive direct and counter-cyclical payments for wheat but actually grow corn or soybeans (and receive marketing loans for the crops actually grown) is ignored. Base acres are larger than payment acres (payment acres=85% of base acres). Payment yields are computed using a formula to update program yields; for consistency, yields here are 93.5% of the 1998-2001 average. In practice, an individual would use farm-level yields, with annual production and prices to determine marketing loans and counter-cyclical payments.