TITLE I
COMMODITY PROGRAMS

SUMMARY OF COMMODITY TITLE REFORM

Recommendations In Brief

Reform farm policy to make it more market-oriented, more predictable, less market distorting and better able to withstand challenge.

Problem

Loan deficiency payments and counter-cyclical payments are designed to provide producers a safety net. However, under the 2002 farm bill, loan deficiency and counter-cyclical payments were largest during years of record-breaking harvests and record farm income. Yet in these same years, natural disasters that caused complete crop loss often left some producers with little safety net whatsoever. John from Kansas described during a USDA Farm Bill Forum how he ended up with no support under the current system. He said, “We didn't raise anything because of the drought. Prices went up and we didn't get any payment. We didn't have anything to sell.” The current price-based programs tend to “under-compensate when yields decline and over-compensate when yields increase.”

Additionally, these payments are being scrutinized by some trading partners who believe they are trade-distorting. In fact, some farm bill programs have already been found noncompliant with international obligations. Further, the U.S. classification of some payments as non-trade distorting (“green box”) is being questioned. With the expiration of the peace clause in the Uruguay Round Agreement, under which domestic support measures were generally, but not fully, protected from challenge, international competitors have already begun to challenge other U.S. commodity programs.

The 2002 farm bill set loan rates at fixed levels significantly above market prices year after year for many crops. Some claim that these high loan rates encourage farmers to plant more of these crops - further increasing supply and thus decreasing prices. These payments can also encourage attempts to produce crops in environmentally-sensitive, drought-prone lands. Furthermore, farmers can take advantage of short-term market events (such as an export terminal closing due to a hurricane) to lock-in artificially high loan deficiency payments, while actually selling the commodity later at prices well above the loan rate. This allows the market price received, combined with the loan deficiency payment, to far exceed the intended loan rate protection.

Payment limits and the Adjusted Gross Income cap have affected few producers. Only nine percent of all farms collect 54 percent of all government commodity payments. The complexity of the law allows virtually unlimited payments to the nation’s largest and most wealthy farms. During Farm Bill Forums, producers spoke often about these wealthier farms inflating cash rental rates and outbidding their neighbors for farm real estate. The nation’s tax policy coupled with these unlimited government payments have contributed to the surge in high land values and high rental rates. As a result, it is more difficult for beginning farmers to get started and for small-l and medium-sized farmers to compete.

During USDA Farm Bill Forums, opinions varied about the commodity title, but many were calling for a change from business as usual. For example, Jeremy from South Dakota wrote, "Subsidies drive up prices all along the production chain, from land to equipment to labor prices…Let free market principles determine the price of a combine, not commodity subsidies." And Mary, from Vermont wrote, "Congress needs to enact (and USDA needs to implement) effective payment limitations on the commodity program so that mega farms are not allowed to drive their neighbors off the land and raise land rental/sale values beyond reachable limits for beginning farmers."

Recommended Solution

The Administration is recommending reforms to Title I – entitled "Commodity Programs." Following is a list of the major components of the commodity title package.

1. Establish market-based loan rates at 85 percent of the 5-year Olympic average with maximum loan rates as established in the House-passed version of the 2002 farm bill. (For further information, see the proposal entitled "Revise Marketing Assistance Loans" on pages 9 – 11.)
2. Replace the current daily posted county prices (PCPs) used for determining loan deficiency payment (LDP) rates and repayment rates for marketing assistance loans with a monthly PCP for each crop. Revise requirements for establishing a producer's LDP and loan repayment rate to be based on the month that beneficial interest is lost. (For further information, see the proposal entitled "Revise Posted County Prices for the Marketing Assistance Loan Program" on pages 12 – 13.)
3. Increase overall direct payments and to provide additional income support in the 2010-2012 crop years. Continue direct payment acres at 85 percent of base acres, and do not update program payment bases and yields. This proposal would pay farmers an additional $5.5 billion over ten years. (For further information, see the proposal entitled "Increase Direct Payments" on pages 14 – 15.)
4. Further increase the direct payments to beginning farmers during their first five years of operation. These enhanced direct payments will invest $250 million in the next generation of production agriculture over ten years. (For further information, see the proposal entitled "Increase Direct Payments for Beginning Farmers" on pages 16 – 17.)
5. Create a counter-cyclical program that is more responsive to actual conditions by replacing current price-based payments with revenue-based payments for program crops. (For further information, see the proposal entitled "Revenue-Based Counter-Cyclical Payment" on pages 18 – 20.)
6. Reform farm program payment limits, eligibility requirements, and attribution to reduce payments going to larger and higher income producers, increasing overall equity in farm programs. (For further information, see the proposal entitled "Strengthen Payment and Eligibility Limits" on pages 21 – 23.)
7. Eliminate commodity program payments for all newly purchased land benefiting from a 1031 tax exchange. (For further information, see the proposal entitled "Section 1031 Exchanges" on pages 24 – 25.)
8. Continue to support the price of milk at $9.90 per cwt, and re-authorize and revise the Milk Income Loss Contract Program (MILC). MILC payments would be based on a

reduced and historical payment rate, instead of actual, milk sales. These proposals are estimated to add $793 million in additional dairy payments over a ten year period. (For further information, see the proposal entitled “Revise Dairy Counter-Cyclical Payments and Continue Price Support Program for Milk” on pages 26 – 27.)

9. Revise the sugar program to operate at no net cost to taxpayers by balancing supply and demand for sugar through domestic marketing allotments and the tariff rate quota on sugar imports. (For further information, see the proposal entitled “Sugar Policy” on pages 28 – 29.)
10. In addition to the action already taken by the Congress to repeal Step 2 of the cotton program, repeal Steps 1 and 3 of the upland cotton competitiveness provision. Eliminate the competitiveness provisions for extra-long staple (ELS) cotton. (For further information, see the proposal entitled “Repeal Special Cotton Competitiveness Provisions” on pages 30 – 31.)
11. Allow planting flexibility of fruits, vegetables, and wild rice on base acres. (For further information, see the proposal entitled “Remove Planting Flexibility Limitations” on pages 32 – 33.)
12. Reduce or eliminate crop bases when an entire farm or a portion of a farm is sold for non-agricultural uses. (For further information, see the proposal entitled “Retire Crop Bases When Cropland Is Sold for Non-Agricultural Uses” on pages 34 – 35.)
13. Offer program crop producers a “conservation enhanced payment option” that enables them to elect to receive an enhanced, guaranteed direct payment if they agree to meet certain conservation requirements and forgo marketing assistance loan program benefits and counter-cyclical program payments. This new program is expected to pay farmers an additional $50 million over the next ten years. (For further information, see the proposal entitled “Conservation Enhanced Payment Option” on pages 36 – 37.)
14. Update Section 1601(e) of the 2002 farm bill entitled “Adjustment Authority Related to the Uruguay Round Compliance” to allow USDA to adjust certain payments to meet current and future WTO commitments. (For further information, see the proposal entitled “Continuing WTO Compliance” on pages 38 – 39.)

REVISE MARKETING ASSISTANCE LOANS

Recommendation In Brief
Establish market-based loan rates at 85 percent of the 5-year Olympic average with maximum loan rates as established in the House-passed version of the 2002 farm bill.

Problem
Loan rates guarantee farmers a “safety net” per unit of covered commodities. However, producers have used marketing strategies to receive large loan deficiency payments at harvest even when they sell their crop later in the year at market prices well above the safety net price. This unintended consequence allows some producers to lock in lucrative payments from the government, even when they actually sell their commodity at levels well above the safety net price prescribed in the 2002 farm bill.

Under the 2002 farm bill, loan rates are fixed for the 2002-2007 crops. As a result, loan rates for some commodities have been established at levels well above market prices year after year. Most claim these fixed loan rates create incentives for producers to plant one crop over another simply because relative loan rates may not reflect the trends in market prices. Most also claim a loan rate in excess of the market price for a crop encourages producers to plant more acreage to that crop, subsequently lowering the crop’s market price and increasing marketing assistance loan outlays even further.

The benefits of the marketing assistance loan program are considered trade distorting and count against the product-specific domestic support under the Aggregate Measurement of Support (AMS) calculation under World Trade Organization (WTO) guidelines.

During USDA’s Farm Bill Forums, producers repeatedly called for greater protection from trade challenges. Rusty in Georgia said, “If we’re going to play in this free trade game and continue to support our farmers, then we need to trade-proof our programs.” Others discussed unintended consequences of some support programs. Jessica of Arkansas said, “Due to these price supports, one of the unintended consequences…has been the artificially inflated cost of land which could cause young farmers to be discouraged from going into the farming business.”

Recommended Solution
To minimize these market distortions and unintended consequences, the Administration recommends a more market-based solution for determining loan rates. All loan rates for commodity crops would be set at the lesser of:

1. 85 percent of the 5-year Olympic average (average of last five years price excluding the high year and the low year).
2. The loan rate levels established in the House-passed version of the 2002 farm bill (no loan rates were set for pulse crops, thus, the loan rates in current law are used to establish a maximum loan rate level for these three commodities).

Commodity	Units	Current	Average of Proposed Loan Rates over 2008-2012 1/	Proposed Maximum
Wheat	$\bu	2.75	2.58	2.58
Corn	$\bu	1.95	1.89	1.89
Sorghum	$\bu	1.95	1.89	1.89
Barley	$\bu	1.85	1.70	1.70
Oats	$\bu	1.33	1.21	1.21
Upland Cotton	$\lb.	0.52	0.4570	0.5192
ELS Cotton	$\lb	0.7977	0.7965	0.7965
Rice	$\cwt	6.50	6.50	6.50
Soybeans	$\bu	5.00	4.92	4.92
Other Oilseeds	$\lb	0.093	0.087	0.087
Peanuts	$\ton	355	336	350
Dry Peas	$\cwt	6.22	5.08	6.22
Lentils	$\cwt	11.72	10.45	11.72
Small Chickpeas	$\cwt	7.43	7.43	7.43
Graded Wool	$\lb	1.00	0.55	1.00
Nongraded Wool	$\lb	0.40	0.22	0.40
Mohair	$\b	4.20	1.92	4.20
Honey	$\lb	0.60	0.60	0.60

1/ Proposed loan rates are calculated for each year, 2008-2012, using actual and projected market prices and then averaged over the 5-year period.

Background

Marketing assistance loans are made by the Commodity Credit Corporation (CCC) to eligible producers on eligible commodities. They provide interim financing to facilitate the orderly distribution of commodities throughout the marketing year. Instead of selling immediately at harvest, the marketing loan program allows a producer who grows an eligible crop to store the production and pledge the crop as collateral. The loan proceeds help the producer to maintain financial stability without having to sell the harvested crop at the time of year when prices tend to be lowest. Later, when market conditions may be more favorable, a producer can sell the crop and repay the loan. Alternatively, the producer may forgo the loan and receive a loan deficiency payment at any time up to the loan availability deadline. Loan proceeds are based on loan rates set by statute and the quantity of eligible commodity pledged.

Recently, a WTO panel on cotton ruled that Step 2 payments, cotton marketing loans, and cotton counter-cyclical payments together contributed to price suppression in world cotton markets. The United States vigorously defended the programs, but as a result of the adverse ruling, terminated the Step 2 program on August 1, 2006. Brazil has requested permission from the WTO to retaliate against the United States, charging that the two remaining U.S. programs — marketing loans and counter-cyclical payments —

continue to suppress world cotton prices. As a result a panel has been established to rule on Brazil’s claims. Preliminary rulings on compliance are expected in 2007.

REVISE POSTED COUNTY PRICES FOR THE MARKETING ASSISTANCE LOAN PROGRAM

Recommendation In Brief

Replace the current daily posted county prices (PCPs) used for determining loan deficiency payment (LDP) rates and repayment rates for marketing assistance loans with a monthly PCP for each crop. Revise requirements for establishing a producer's LDP and loan repayment rate to be based on the month that beneficial interest is lost.

Problem

The current system of using PCPs to determine LDPs and permit loan repayment has enabled producers to receive financing early in the harvest season, avoid forfeitures, and allow commodities to be marketed in response to demand. However, the PCP system suffers from a series of problems. First, calculating 80,000 PCPs daily is a massive undertaking and leads to errors. Because PCPs are designed to reflect local market prices, lack of information on local market conditions can lead to PCPs that do not reflect local conditions and to PCPs that have unwarranted differences from one county to the next. Second, an unusual short-term event may cause a short-term decline in market prices, triggering a large volume of LDP requests at a high LDP rate that may not reflect the longer-term or underlying market conditions. This leads to excessive costs of the marketing loan program. Third, producers may take advantage of short-term price depressions to obtain an LDP and then market the crop later in the year, with the resulting market price plus LDP greatly exceeding the loan rate. In this case, the producer receives total compensation much greater than intended by the loan program.

The unintended levels of compensation were noted in several USDA Farm Bill Forum comments. Ellen from North Dakota said, "As the program exists right now there are in fact no limits on commodity payments that can be received, especially with respect to marketing loan gains."

Recommended Solution

The Administration recommends replacing the daily PCP with a monthly PCP. The monthly PCP would be an average of five daily PCPs on pre-set days during the previous month, excluding the high and low daily PCP. This new system would apply to all covered commodities except upland cotton, rice, wool, mohair, and honey. A producer who elects to forgo a marketing assistance loan and receive an LDP during any month would receive the LDP rate in effect on the day the producer loses beneficial interest in the commodity. The LDP rate would be the difference between the applicable loan rate and the monthly PCP. For a producer who elects to take out a marketing assistance loan, the loan repayment rate would be the loan rate plus interest, unless the producer loses beneficial interest immediately upon repayment of the loan. In that case, the loan would be repaid at the PCP in effect for the month if the PCP is less than the loan rate plus interest. If the loan is carried to maturity, the loan repayment rate would be the PCP in effect during the month the loan matures or during the last month of the commodity marketing year, whichever is earlier. For those producers who do not lose beneficial interest (silage producers, farmer-feeders, etc.), USDA would establish a payment rate for these producers based on the average of the monthly PCPs during the first three months of the marketing year.

Background

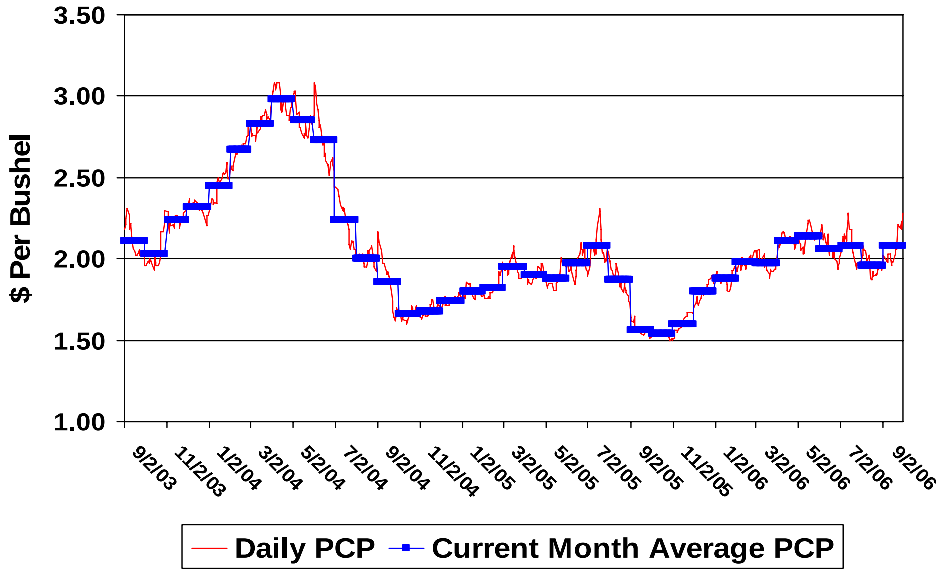
Producers may receive a nonrecourse marketing assistance loan for eligible commodities. They may settle their outstanding loan during the loan period by repaying the loan or, upon maturity, by forfeiting the commodity pledged as collateral for the loan to the Commodity Credit Corporation (CCC). A producer may repay the loan at the loan repayment rate which is the applicable county loan rate, plus accrued interest and other charges (per bushel or cwt) or the announced loan repayment rate for the respective commodity. Announced loan repayment rates, or PCPs, are established and available each day based upon the previous day's market prices at appropriate U.S. terminal markets, adjusted to reflect quality and location, for grains and soybeans. Each day, some 80,000 PCPs are announced by USDA. In addition, a producer eligible to obtain a marketing assistance loan may agree to forgo the loan and receive an LDP. The LDP rate equals the amount by which the county loan rate exceeds the announced loan repayment rate for the commodity.

Establishing the LDP rate or the loan repayment rate on the date the producer loses beneficial interest in the commodity would enable the producer to receive the price support provided by the loan rate while limiting excessive LDPs and marketing loan gains. A producer has beneficial interest in the commodity if all of the following remain with the producer: control of the commodity, risk of loss, and title to the commodity.

The following chart is an example of daily versus monthly PCPs:

PCP EXAMPLE: COMPARISON OF ACTUAL AND ALTERNATIVE PCPs FOR CORN

CENTRAL ILLINOIS, Sept. 1, 2003-Sept. 30, 2006



INCREASE DIRECT PAYMENTS

Recommendation in Brief

Increase overall direct payments and to provide additional income support in the 2010-2012 crop years. Continue direct payment acres at 85 percent of base acres, and do not update program payment bases and yields. This proposal would pay farmers an additional $5.5 billion over ten years.

Problem

While program crop prices are generally expected to remain firm or increase over the next few years, upland cotton is an exception. The combination of increases in upland cotton yields per acre and declining U.S. upland cotton textile production is expected to limit price gains and result in substantial cotton program expenditures, compared to other commodities.

The 2002 farm bill permitted producers to update their program crop base acres and yields. For the purposes of World Trade Organization obligations, updating bases and yields for direct payments would connect them more closely to current production and could jeopardize their "green box" status, causing these payments to be categorized as trade distorting "amber box" assistance.

Recommended Solution

The Administration proposes increased direct payment rates. In addition, the Administration proposes increased direct payment rates for commodities other than upland cotton in the 2010-2012 crop years to reduce the risk of weaker markets, with this increase totaling $1 billion over the three years.

The chart below shows direct payment rates for 2007 under current law compared to USDA's proposed direct payment rates for 2008-2017 crop years:

Crop	Current Law 2007	USDA Proposal 2008-2009 and 2013-2017	USDA Proposal 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

Additionally, to avoid jeopardizing the status of direct payments as non-trade distorting "green box" support, direct payment base acres and yields should not be updated. Payment acres should continue at 85 percent of base acres.

USDA Farm Bill Forums brought forth a diversity of opinions about direct payments. Many producers commented on the benefits of direct payments in the world trade arena. Brian from Minnesota wrote, "I support continuing decoupled payments based upon cropping history rather than current plantings."

Background

The Direct Payment Program (part of the Direct and Counter-Cyclical Program, or DCP) provides payments to eligible producers on farms enrolled in DCP during the 2002-2007 crop years. Direct payments are computed using the base acres and payment yields established for each farm and are available for barley, corn, grain sorghum, oats, other oilseeds (canola, crambe, flaxseed, mustard seed, rapeseed, safflower, sesame, sunflower seed), peanuts, rice, soybeans, upland cotton, and wheat.

For each commodity, the direct payment for each crop year equals 85 percent of the farm's base acreage *multiplied by* the farm's direct payment yield *multiplied by* the direct payment rate. Direct payments are not based on producers' current production choices, but instead are tied to historical, fixed acreages and yields. Because direct payments provide no incentive to increase production of any particular crop, the payments support farm income without affecting producers' current production decisions.

For the purposes of reporting payments to the WTO, subsidies are classified into "boxes" that are given the colors green, blue, and amber.

Domestic support measures considered to distort production and trade fall into the "amber" box. These include measures linked to current production and prices. The U.S. amber box limit for product-specific support is $19.1 billion per year.

The "blue box" contains conditions designed to reduce distortion. Any support that would normally be in the amber box, but also requires farmers to limit production, can be placed in the blue box. There are currently no limits on spending on "blue box" subsidies.

"Green box" programs include farmer support that is not related to current production levels or prices. Examples include direct payments and qualifying research, environmental protection and rural development programs. "Green box" subsidies are therefore allowed without limits.

The 2002 farm bill permitted producers to update their program crop base acres and permitted updating of payment yields for counter-cyclical payments, if bases were updated. Payment yields for direct payments were not allowed to be updated.

INCREASE DIRECT PAYMENT FOR BEGINNING FARMERS

Recommendation in Brief

Further increase the direct payments to beginning farmers during their first five years of operation. These enhanced direct payments will invest $250 million in the next generation of production agriculture over ten years.

Problem

Beginning farmers and ranchers face barriers to entering production agriculture. Farming is a high-cost business and a significant percentage of these costs must be invested up-front as a new producer is getting started. Land values and rental rates in the major program crop regions have significantly increased. National average farmland values have increased 65 percent in the past five years, from $1,150 per acre in 2001 to $1,900 per acre in 2006. Average cropland rental rates increased from $71 per acre in 2001 to $79 per acre in 2006, or 11 percent over the same period.

The amount and cost of equipment, including planting, cultivation and harvest machinery, exemplifies the financial barriers to entering production agriculture. The price of a representative front-wheel-assist 250 horsepower tractor ranges from $180,000 to $200,000. Harvest equipment may be even more expensive, with a standard combine often costing more than $200,000. Lease costs are substantial as well.

This issue was raised repeatedly during USDA's Farm Bill Forums. Comments made by Cameron, of Ohio, represent the comments of many stakeholders. He said, "It is almost impossible for a young person to get started in farming. The current program does not do enough to help the younger farmer get established but almost hurts him because of the competition from larger established farmers and the government payments they receive."

Recommended Solution

To better prepare beginning farmers to face the initial financial burdens associated with entering production agriculture, the Administration recommends that beginning farmers receive an increased direct payment rate. The direct payment rate for beginning farmers should be determined by multiplying the covered commodity direct payment rate by 1.20. After the initial five years, the producer would no longer be eligible for a higher direct payment rate.

Vince, from Montana, is among the producers who strongly encouraged the department to expand support for beginning farmers. Vince specifically lauded direct payments. He wrote, "Because I am a beginning farmer, I was able to acquire a FSA guarantee on my farm's land loan. It is the direct payment in the current farm program that provides the stability I require for my budget and cash flow projections…When projecting my next year's budget, the direct payment is the only number I have been able to guarantee as fixed income. Without it, my land payment would be at risk."

Background

The Direct Payment Program (part of the Direct and Counter Cyclical Program, or DCP) provides payments to eligible producers on farms enrolled for the 2002 through 2007 crop years. Direct payments are computed using the payment rates in statute and the base acres and payment yields established for each farm. Direct payments are available for barley, corn, grain sorghum, oats, and other oilseeds (canola, crambe, flax, mustard, rapeseed, safflower, sesame and sunflower seeds), peanuts, rice, soybeans, upland cotton, and wheat.

For each commodity, the direct payment for each crop year equals 85 percent of the farm's base acreage *multiplied by* the farm's direct payment yield *multiplied by* the direct payment rate. Direct payments are not based on producers' current production choices, but instead are tied to historical, fixed acreages and yields. Because direct payments provide no incentive to increase production of any particular crop, the payments support farm income without affecting producers' current production decisions.

REVENUE-BASED COUNTER-CYCLICAL PAYMENT

Recommendations In Brief

Create a counter-cyclical program that is more responsive to actual conditions by replacing current price-based payments with revenue-based payments for program crops.

Problem

Current price-based counter-cyclical payments are based on fixed program payment yields and acreages. Thus when market prices drop below the level that triggers a counter-cyclical payment, payments are made regardless of the level of yields. By failing to take into account actual production per acre, current counter-cyclical payments tend to under-compensate producers when yields decline and over-compensate producers when yields increase.

During USDA Farm Bill Forums, the idea of counter-cyclical payments based on revenue was repeatedly echoed. Ernie from Nebraska said, “Too often our farm policy focus is only on prices. The focus, we feel, should really be on revenue which takes into account both prices and yields… [The current farm bill] tends to overcompensate when it should not and under-compensate when more assistance is needed.” John from Kansas said, “We didn't raise anything because of a drought. The prices went up and we didn't get any payment; we didn't have anything to sell. A target revenue program would fix that."

In 2004-2005, historically high yields for corn and cotton drove supplies up and consequently prices down, triggering counter-cyclical payments for both crops. While prices were down, bushels and pounds sold by farmers were up, yielding unexpectedly high market revenues. Nonetheless, the counter-cyclical payment formula under the 2002 farm bill paid additional money to producers who were already experiencing above average revenues. Conversely, if a farmer is experiencing a drought and yields are low, commodity prices are often above the counter-cyclical price trigger. If producers have few or no commodities to sell at the high price, their farm revenue suffers, yet because the market price is above the counter-cyclical price trigger producers receive no payments. In cases such as these, unexpected market conditions yield unintended consequences.

Recommended Solution

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

The national target revenue per acre for the commodity would equal the 2002 farm bill’s target price minus the 2002 farm bill’s direct payment rate multiplied by the national average yield for the commodity during the 2002-2006 crop years, excluding the high and the low years. The national actual revenue per acre for a commodity would equal the national average yield for the commodity times the higher of: (1) the season-average market price and (2) the loan rate for the commodity.

If a payment is triggered, the national revenue-based payment per acre would be converted to a payment rate for producers by dividing the national revenue payment per acre by the U.S. average payment yield per base acre under the 2002 farm bill countercyclical payment program. An individual producer's revenue-based counter-cyclical payments would be determined by multiplying the national average payment rate for the commodity times 85 percent of the producer's base acres times the producer's program payment yield under the 2002 farm bill countercyclical payment program.

Base acres and program payment yields would remain fixed over the life of the 2007 farm bill. The national yield for determining target revenue would remain fixed over the life of the 2007 farm bill and would equal the average yield for the 2002-2006 crops, excluding the high and the low year.

Background

Price-based counter-cyclical payments established under the 2002 farm bill are triggered when the effective price for a covered commodity falls below the target price for the commodity. The effective price is the sum of: (1) the higher of the season-average market price or the national average loan rate for the commodity and (2) the direct payment rate for the commodity. Since current counter-cyclical payments are not directly tied to actual yields, they may over-or-under compensate producers for annual fluctuations in market revenue. For example, when yields are above trend, causing market prices to decline, current counter-cyclical payments can over-compensate producers since higher yields offset some revenue lost from lower market prices. The opposite occurs when yields are below trend. In this situation, lower production can cause market prices to increase and counter-cyclical payments to decline – even to zero. However, because revenue per acre may change only slightly or even decrease as a result of declining yields per acre, revenue-based payments would be more responsive to actual conditions.

The following page provides examples of how the program would operate in a hypothetical year for corn.

Price-Based Versus Revenue-Based Payments: Price and Revenue Guarantees

U.S. Data	Current Price-Based	U.S. Data	Recommended Revenue-Based
Target Price	$2.63/bu.	**Target Price**	$2.63/bu.
Direct Payment	$0.28/bu.	**Direct Payment**	$0.28/bu.
Price Guarantee	$2.35/bu.	**Difference**	$2.35/bu.
Program Yield (bu./ac.)	114.3 bu./ac.	**Olympic Average Yield (2002-2006)**	146.4 bu./ac.
		Target Revenue	344.04

Price-Based Versus Revenue-Based Payments: Payment Calculation
Example # 1—Higher Yield, Lower Price

U.S. Data	Assume Actual Price=$2.00/bu.; Yield=170.0/bu.; Revenue=$340.00/ac.	
	Price-Based	**Revenue-Based**
Price-Based Payment Rate Per Bushel (1)	$0.35	--
Program Yield	114.3 (bu./ac.)	114.3 (bu./ac.)
Revenue-Based Payment Per Acre (2)	--	$4.04
Payment Rate Per Bushel (3)	--	$0.035

(1) $0.035 = $2.35 - $2.00
(2) $4.04 = $344.04 - $340.00
(3) $0.035 = $4.04/114.3

Price-Based Versus Revenue-Based Payments: Payment Calculation
Example # 2—Lower Yield, Higher Price

U.S. Data	Assume Actual Price=$2.30/bu.; Yield=130.0/ac.; Revenue $299.00/ac.	
	Price-Based	**Revenue-Based**
Price-Based Payment Rate Per Bushel (1)	$0.05	--
Program Yield	114.3 bu./ac.	114.3 bu./ac.
Revenue-Based Payment Per Acre (2)	--	$45.04
Payment Rate Per Bushel (3)	--	$0.394

(1) $0.05 = $2.35 - $2.30
(2) $45.04 = $344.04 - $299.00
(3) $0.394 = $45.04/114.3

STRENGTHEN PAYMENT AND ELIGIBILITY LIMITS

Recommendation in Brief

Reform farm program payment limits, eligibility requirements, and attribution to reduce payments going to larger and higher income producers, increasing overall equity in farm programs.

Problem

Farm program payments account for a sizeable share of farm income for producers of program crops. Generally, the effect of payment limits has been limited because producers have been able to use various legal and regulatory provisions to avoid being restricted by these limits. The Commission on the Application of Payment Limitations for Agriculture authorized in the 2002 farm bill found the “limits on marketing loan benefits are not effective, only a small percentage of program crop producers reach the current limits on direct and counter-cyclical payments, and many of the largest farms have either restructured or are likely to do so to lessen the extent to which the limits reduce payments.”

With only limited constraints on payments, a substantial portion of payments go to large, high income producers. In 2005, commercial farms (defined as a farm with sales of $250,000 or more, where the principal occupation of the operator is farming) accounted for nine percent of all farms but received 54 percent of all government payments, averaging $54,100 per farm. These farms had average household incomes of $200,000. Farms where the principal occupation of the operator was farming and with sales up to $250,000 (intermediate farms) accounted for 23 percent of farms and received 27 percent of all payments, averaging $8,700 per farm. These farms had average household incomes of $68,000. The U.S. average household income was $63,344 in 2005. These data indicate most payments go to farm households that have large incomes compared with other farms and with U.S. average household income. Moreover, these large payments are likely to provide a means and incentive for the “big to get bigger” and outbid their neighbors in purchasing and renting farmland.

The problem was highlighted in the comments offered during many Farm Bill Forums. Kristina from Virginia said, “Farm bill policies are supposed to preserve family farms, but they disproportionately channel money to big agribusiness.” Steve from Georgia said, “These people drawing these multiple payments are in competition against us… They… keep getting bigger every year. The number of farmers drops every year. There's going to be fewer and fewer farmers, and there won't be such a thing as a family farm.”

Recommended Solution

The Administration proposes increasing the effectiveness of farm bill payment limits and helping assure equity among farmers.

1. Decrease the Adjusted Gross Income (AGI) eligibility cap for all farm commodity program payments from the current $2.5 million to $200,000 annually. Continue current law AGI requirements and payment limits on all conservation title payments.
2. Repeal the current provision in law that waives the AGI cap if 75 percent or more of the AGI is derived from farming, ranching, or forestry activities. Thus, if a producer has an annual adjusted gross income of $200,000 or more, regardless of the source of the income, the producer would not be eligible for commodity program payments.
3. Replace the three entity rule with direct attribution of payments, so that all payments are attributed to natural persons directly and through entities that are determined to be actively engaged in agriculture.
4. Maintain the effective overall payment limit of $360,000 but adjust the separate payment limits on specific types of payments – from $80,000 to $110,000 for direct payments, from $130,000 to $110,000 for counter-cyclical payments, and from $150,000 to $140,000 for marketing loan gains.
5. Repeal honey, peanut, wool, and mohair program-specific payment limits (i.e., establish one comprehensive payment limit per person for all commodity program payments including dairy, not one limit for one set of commodity payments and another limit for other commodity payments).
6. Issue new rules that strengthen the now difficult-to-measure requirements for the active management contribution to the operation that enables individuals or entities to qualify for commodity program payments without contributing labor to the operation. Landowners who contribute land to an operation and receive rent in the form of a share of production of a program commodity produced on the land would continue to be considered actively engaged in agriculture and eligible for program payments.
7. Issue rules to institute new procedures to validate producer AGI and eligibility for payments to help ensure no erroneous payments are made.
8. Establish a de minimis level on the issuance of direct and countercyclical payments. To achieve efficiencies in the distribution of payments, no payment of $10.00 or less would be issued under the direct and countercyclical payment programs. In 2004, USDA made direct payments of $10.00 or less to 27,809 producers. These payments totaled $93,711.

Comments submitted during USDA's Farm Bill Forums offered varying opinions about payment limits. Some spoke passionately about the need for greater equity in distribution. Janet from North Dakota said, "We ask that changes be made in our agricultural support system which will do more than use family farmers as the poster children for ag spending. Put a cap on subsidies and close the loopholes which allow an unfair advantage to a few." Paul from Minnesota said, "You need to do something about a more equitable distribution so that the dollars are not going just to the largest farmers."

Internal Revenue Service (IRS) data for 2004 indicate that 97.7 percent of all American tax filers have an AGI under $200,000 and only one half of one percent of all Americans have an AGI over $500,000. Compared to the $2.5 million AGI cap in current law, less than .0007 percent of all American tax filers have an AGI of over $2.5 million. Put another way, less than seven in every 10,000 American families have an AGI over $2.5 million. Looking at farmers specifically, 2003 IRS data indicate that approximately two million tax filers submitted a Schedule F – reporting a profit or loss from farming. Of these, only 71,800 — 3.6 percent — reported AGI of $200,000 or more. This data also indicates that 4.5 percent of farm program payments (including Conservation Reserve Program Payments) went to the 3.6 percent of Schedule F filers with AGI of $200,000 or more.

Background

A limitation on the total annual payments that a "person" may receive under certain commodity programs has been in effect since enactment of the Agricultural Act of 1970. Subsequent farm legislation continued payment limitation requirements and added other income limitations. Most notably, the 2002 farm bill added a $2.5 million AGI limitation with respect to these programs. An individual or entity is not eligible for farm program and other payments if the individual's or entity's average AGI exceeds $2.5 million for the three tax years immediately preceding the applicable crop, program, or fiscal year. AGI for an individual filing a separate tax return is the amount reported as "adjusted gross income" on the Federal tax return for the individual for the applicable tax year, which includes wages, salaries, dividend and interest income, capital gains, net farm income (gross farm income minus farm expenses including depreciation) and other sources of income. Similar definitions apply to individuals filing joint returns, corporations, partnerships, trusts, etc. However, an individual or entity is considered eligible to receive farm program payments regardless of the level of AGI if 75 percent or more of the average AGI is derived from farming, ranching, or forestry operations. Reducing the AGI cap and repealing the 75 percent exception would reduce the number of high income households receiving farm income support.

Eliminating the three entity rule would allow transparent identification of payments to individuals and would reduce the incentive to create business organizations for reasons other than risk or business considerations.

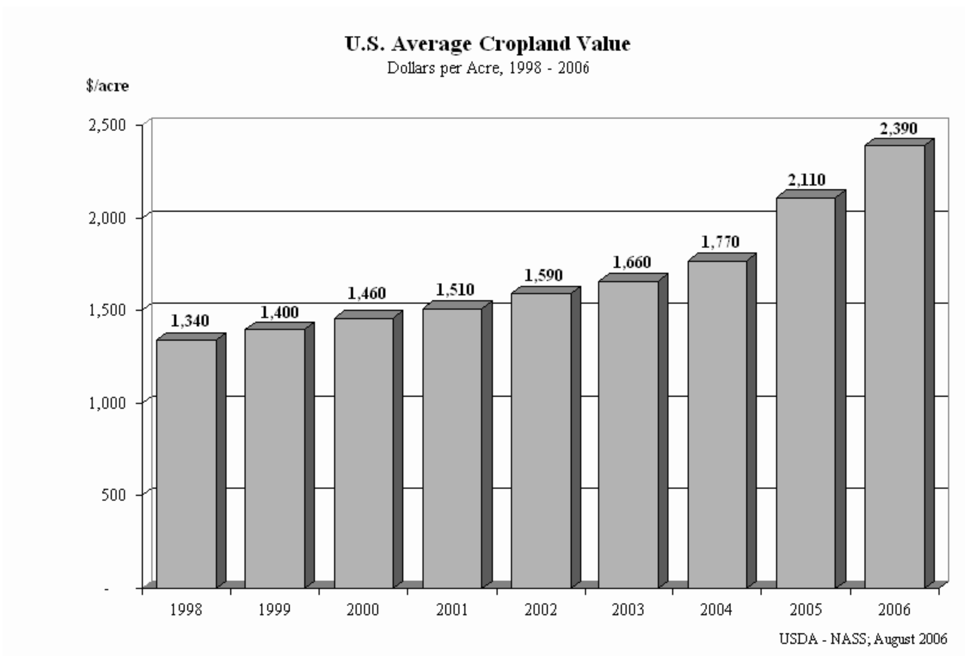
SECTION 1031 EXCHANGES

Recommendation In Brief

Eliminate commodity program payments for all newly purchased land benefiting from a 1031 tax exchange.

Problem

While many farmers are reporting significant economic hardship, land values have continued to climb. Average farm real estate value increased over 90 percent from $974 per acre in 1998 to $1,900 per acre in 2006. During that same period, the average value of cropland increased almost 80 percent to an average $2,390 per acre.



High land values continue to be a barrier for new farmers who are seeking to enter production agriculture. These high land values are also problematic for small and socially disadvantaged farmers who are seeking to expand their operations.

A reoccurring theme at USDA Farm Bill Forums centered on how individuals near urban areas sold their land and moved to more remote areas where they outbid local farmers for farmland, simply to take advantage of the 1031 tax exchange. For example, Troy, a 26-year-old college graduate in agribusiness from Utah said, “It has always been my dream to be able to someday own my own farm. Currently, I am unable to do so due to the giant barrier of entry which is land values….This is mainly due to speculation of real estate and 1031 exchanges.” Ronald from Minnesota caused a round of applause when he stated “it's the 1031 tax exchange that's killing the young farmer.” And Len from Wisconsin added, “The 1031 is just driving our land rents and land prices to where the average producer, even big producers can't compete.”

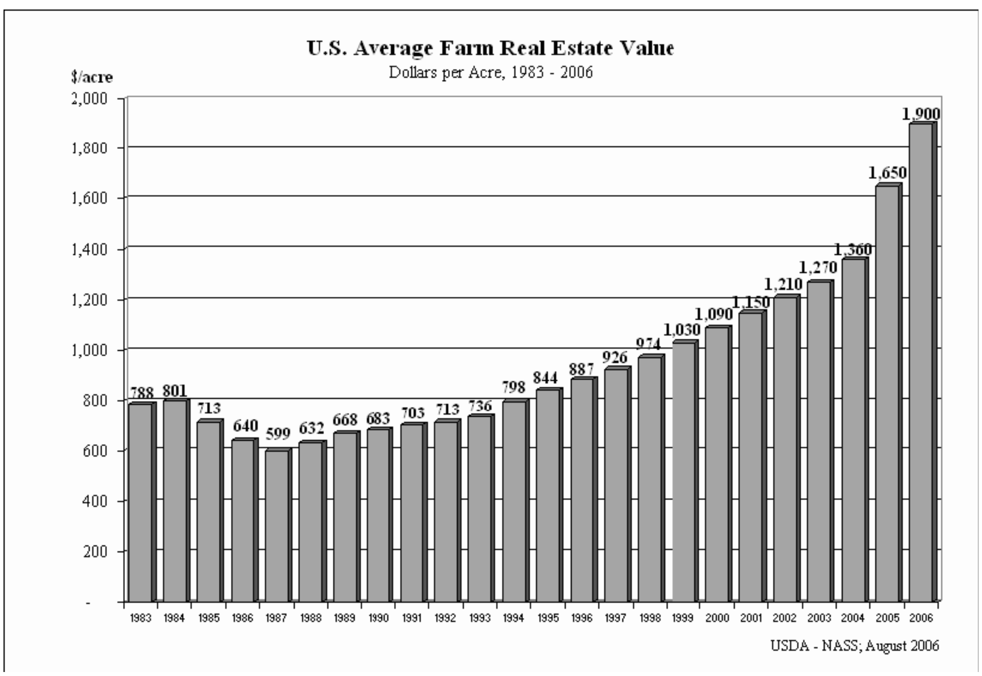
Recommended Solution

To help rectify this situation, USDA proposes to eliminate eligibility for direct payments, counter-cyclical payments and marketing loan benefits on land purchased after the date of enactment of the 2007 farm bill through a 1031 exchange. This policy change will help mitigate an unintended consequence of the tax code by allowing the market, not the tax code, to drive land purchases and prices.

Background

Section 1031 of the U.S. Internal Revenue Code allows investors to defer capital gains taxes on the exchange of like-kind properties. Like-kind (tax-deferred) exchanges, or “1031 tax deferments,” can affect rural farmland values. Under “1031 tax deferments,” landowners selling land at a profit can defer taxes on that profit by using the proceeds to acquire similar property for business or investment purposes. These taxes can be significant because urban expansion has caused a rapid increase in nearby agricultural land values. As farmers, ranchers, and others sell land, usually for nonfarm use, in these urban-affected areas, they may acquire farmland in more rural locations to avoid taxes.

Agricultural land value reflects the future value of agricultural production from that land (measured in current dollars), but also includes factors such as urban development pressures and recreational uses. Agricultural land values rose sharply in the 1970s and early 1980s, declined rapidly between 1982 and 1987, and have risen steadily since 1987.



REVISE DAIRY COUNTER-CYCLICAL PAYMENTS AND CONTINUE PRICE SUPPORT PROGRAM FOR MILK

Recommendation In Brief

Continue to support the price of milk at $9.90 per hundredweight (cwt), and re-authorize and revise the Milk Income Loss Contract Program (MILC). MILC payments would be based on a reduced and historical payment rate, instead of actual milk sales. These proposals are estimated to add $793 million in additional dairy payments over a ten-year period.

Problem

Operation of the milk price support program has helped to provide stability to producers' milk prices. Counter-cyclical payments to dairy producers are triggered under the MILC program when the Class I price in Boston in any month falls below $16.94 per cwt. The MILC program is not consistent with the other farm bill counter-cyclical programs that require payments to be based on historical production levels and an 85 percent payment rate.

Under the 2002 farm bill, authority for the MILC program expired on September 30, 2005. The Deficit Reduction Act of 2005 extended the MILC program authorizing payments through August 31, 2007, but no payments are authorized thereafter. Because the MILC program expires prior to expiration of the 2002 farm bill, the MILC program is not part of the 2007 farm bill baseline spending for FY 2008-2017. Thus, a continuation of the program in the 2007 farm bill would cause farm bill program spending to exceed baseline spending.

During USDA's Farm Bill Forums, dairy farmers from throughout the country let their views be known. For example, Ed from Wisconsin said, "We see the MILC program as an important supplement to the milk price support program, which is also an important part of the dairy income safety net. However, the milk price support program, by itself in its current form, is an insufficient safety net for dairy producers." And Calvin from Florida added, "We support the continuation of this relatively low cost safety net for dairy farmers…With the large investment required of dairy operations and the time frame required to enter dairy farming it is imperative that a floor be kept on dairy prices to maintain an adequate milk supply. The dairy price support program is a win-win for producers, processors, and consumers."

Recommended Solution

The Administration proposes to maintain the milk price support program and extend the MILC program. Under the proposed MILC program, dairy producers would continue to be eligible to receive a payment if the Class I price in Boston in any month falls below $16.94 per cwt. For FY 2008, the proposed payment rate would remain at the current rate of 34 percent of the difference between $16.94 per cwt and the Class I price in

Boston. For subsequent years, the payment rate would be phased down to 31 percent in FY 2009, 28 percent in FY 2010, 25 percent in FY 2011, 22 percent in FY 2012, and 20 percent in FY 2013-2017.

MILC payments would be based on 85 percent of the 3-year average of milk marketed during fiscal years 2004-06. Payments would be subject to the current quantity-based limit on milk marketed eligible for MILC payments of 2.4 million pounds per year. This policy change would make the MILC program consistent with the other farm bill counter-cyclical programs that are calculated on historical production bases. MILC payments would also count towards a producer's overall counter-cyclical payment limit of $110,000 annually, helping to limit payments to producers with multiple dairy operations. The new adjusted gross income eligibility cap of $200,000 annually would also apply to MILC payments.

Background

The Milk Price Support Program (MPSP) supports the price of milk produced in the 48 contiguous states through the purchase of cheese, butter, and nonfat dry milk (NDM). The current milk price support rate is $9.90 per cwt. for milk testing 3.67 percent butterfat (milk fat). Under the MPSP, farmers are not paid directly but are supported through Federal purchases of dairy products. Purchases vary from year to year depending on the dairy market supply and demand situation and the support rate.

In recent years, the average price received for milk has been well above the support price and only very small amounts of nonfat dry milk, butter and cheese have been removed from the market to support the price of milk. Current projections suggest that the farm-level price of milk will continue to remain considerably above the support price and purchases under the milk price support program will remain small.

Besides MPSP, the MILC program is also available to dairy producers. MILC program payments are made on a monthly basis when the Class I milk price in Boston falls below the benchmark price of $16.94 per cwt. A maximum of 2.4 million pounds of milk marketed by an operation are eligible for MILC payments per fiscal year. MILC program payment rates are currently determined by multiplying 34 percent of the difference between $16.94 and the Boston Class I price for the month. By statute, no payments are authorized under the MILC program after August 31, 2007.

SUGAR POLICY

Recommendation In Brief

Revise the sugar program to operate at no net cost to taxpayers by balancing supply and demand for sugar through domestic marketing allotments and the tariff rate quota (TRQ) on sugar imports.

Problem

The sugar program is a nonrecourse loan program that supports the price of raw cane sugar at 18 cents per pound and refined beet sugar at 22.9 cents per pound. The 2002 farm bill requires the Secretary of Agriculture to establish domestic allotments that result in no forfeitures of sugar to the Commodity Credit Corporation (CCC) under the sugar price support program. However, the 2002 farm bill suspends the requirement when sugar imports for human consumption are expected to exceed 1.532 million short tons, and the imports would lead to a reduction in the overall allotment quantity. The current program limits imports of raw and refined sugar through a TRQ. Under the World Trade Organization (WTO), the United States is subject to minimum access requirements consistent with U.S. obligations.

Because of increased sugar imports expected from Mexico, which, under the NAFTA agreement, is not subject to the TRQ, USDA's current long-term projections indicate imports in excess of 1.532 million short tons, triggering the suspension of domestic marketing allotments during FY 2008-2017. As a result, U.S. sugar supplies are projected to exceed domestic use, and domestic sugar placed under nonrecourse loans would be forfeited to the Commodity Credit Corporation. USDA's projected outlays under the sugar price support program are $1.4 billion during FY 2008-2017.

Recommended Solution

The Administration recommends continuing the sugar price support program but eliminating the provision which requires the Secretary of Agriculture to suspend marketing allotments when sugar imports are projected to exceed 1.532 million short tons. Domestic marketing allotments for sugarcane and sugar beets could be reduced, as needed, to balance sugar supply and demand and prevent price support forfeitures. The sugar program could then continue to be operated at no net cost to taxpayers as it traditionally has in the past.

USDA heard divergent views on U.S. sugar policy. For example, Stephen, from Hawaii wrote, "We strongly urge that a no-cost U.S. sugar policy be retained in the next farm bill." While Stephen, from California, suggested, "A good start would be the end of ridiculous sugar price supports, benefiting the few at the expense of many -- not only all U.S. consumers, who pay artificially high prices for sugar products, but poor cane growers in other nations, who can't compete with our artificially priced products."

Background

The objective of the Administration's proposal would be to continue to maintain domestic sugar prices near historical levels while eliminating the Federal cost of the sugar price support program. On January 1, 2008, full implementation of NAFTA eliminates all customs duties for sweetener trade between Mexico and the United States. Relative costs of production, transportation, and other market factors will determine where sugar crops are grown and processed in the United States and Mexico following elimination of customs duties on sweeteners trade between the two countries. If price supports for raw and refined sugar remain at current levels, U.S. prices would likely attract imports from Mexico. Depending on the volume of imports from Mexico, sugar prices could drop below the forfeiture level resulting in U.S. sugar program costs. USDA currently projects sugar program costs of $1.4 billion during FY 2008-2017, an average of $140 million per year, due to anticipated forfeitures. Under the proposal, the domestic marketing allotment program would be available to reduce domestic sugar supplies and support sugar prices for producers when imports exceed 1.532 million short tons.

Sugar imports from Mexico were 784,000 tons in FY 2006 and are projected at 330,000 tons for FY 2007. Prior to FY 2006, over-quota tariffs restricted imports to about 25,000 tons per year.
The over-quota tariff is currently $0.015 per pound, and drops to zero on January 1, 2008.

REPEAL SPECIAL COTTON COMPETITIVENESS PROVISIONS

Recommendation In Brief
In addition to the action already taken by the Congress to repeal Step 2 of the cotton program, repeal Steps 1 and 3 of the upland cotton competitiveness provision. Eliminate the competitiveness provisions for extra-long staple (ELS) cotton.

Problem
In the cotton dispute brought by Brazil, the World Trade Organization (WTO) ruled that Step 2 payments for cotton users and exporters under the 2002 farm bill were prohibited subsidies contingent on exports or on the use of domestic over imported cotton. Congress subsequently repealed the Step 2 payment provisions. Step 2 was part of a set of three competitiveness provisions in the 2002 farm bill. The other two provisions -- a discretionary adjustment in the loan repayment rate and a special import quota -- have seldom been used, have increased program costs when used, and have had little meaning in the absence of Step 2.

The ELS cotton program includes a payment to domestic users and exporters that is analogous to the upland cotton Step 2 program.

Recommended Solution
Repeal Step 1, the discretionary adjustment in the loan repayment rate, and Step 3, the special import quota for upland cotton. Congress has already eliminated the Step 2 program for upland cotton. Steps 1 and 3 remain in law and should be repealed. Repeal the ELS competitiveness payment which is analogous to the Step 2 payment for upland cotton.

Background
The upland cotton program is comprised of a non-recourse marketing assistance loan and a 3-step competitiveness provision. The non-recourse marketing loan allows a producer to:

1. Place cotton under loan for up to 9 months,
2. Receive some money up front, which can be used to pay production expenses, and
3. Wait for an advantageous move in prices to market the cotton.

If subsequent prices do not allow the producer to repay the loan and receive a higher price, then at the end of the 9-month loan the producer can forfeit the cotton as payment in full for the loan. If the producer elects to repay the loan prior to maturity, the producer may repay the loan, at the lower of:

1. The loan rate, plus applicable storage and interest, or
2. An alternative repayment rate, called the adjusted world price (AWP), announced each Thursday.

Step 1 of the 3-step competitiveness provision for upland cotton is a discretionary adjustment to the AWP. The Secretary may, when certain conditions are met, reduce the AWP by an amount not to exceed the difference between the A-Index and the lowest U.S. quotation in Northern Europe (USNE). The decision concerning the discretionary Step 1 adjustment is based upon several factors including the likelihood of achieving the prevailing export forecast, and the likelihood of forfeiture of loan collateral in the absence of the adjustment. The discretionary reduction has seldom been used, and when used, it increases the cost of the cotton program.

Step 2 of the 3-step competitiveness provision, now repealed, was designed to ensure that U.S. upland cotton could be readily marketed in both the domestic and international market. Step 2 operated when U.S. upland cotton prices were above world prices for a certain period and provided a subsidy to domestic users and exporters in the amount of the difference between the U.S. and world prices.

Step 3 of the 3-step competitiveness provision allows for the opening of a special additional import quota for upland cotton. These quotas permit importation of cotton above that permitted under existing quotas. Step 3 import quotas are triggered when U.S. cotton prices quoted in Northern Europe exceed world prices in Northern Europe for a specified period by more than the Step 2 payment rate. When the Step 2 provision was adopted, there was concern that it could result in exports of domestic supplies and lower prices to foreign buyers. The provision was enacted to provide domestic textile mills access to foreign cotton should U.S. prices rise and supplies tighten due to Step 2. Without Step 2, there is no basis for Step 3.

The ELS program provides payments that are analogous to the Step 2 payments. When U.S. ELS cotton prices are above world prices for a certain period, a payment is made to domestic users and exporters in the amount of the difference between the U.S. and world prices.

REMOVE PLANTING FLEXIBILITY LIMITATIONS

Recommendation in Brief

Allow planting flexibility of fruits, vegetables, and wild rice on base acres.

Problem

Under World Trade Organization (WTO) rules, direct payments can be classified as non-trade-distorting or "green box" support if, among other conditions, they are not "related to, or based on, the type or volume of [current] production" by the recipient. In the Brazil cotton case, the WTO ruled that direct payments provided under the 2002 farm bill could not be classified as "green box" support, because of the limitations on planting flexibility that currently prohibit the planting of fruits, vegetables, and wild rice on base acres eligible for payments. The WTO reasoned that because direct payments are conditioned on the recipients' avoiding production of certain crops after the base period, they are related to current production and thus do not meet the criteria for decoupled income support as defined in the WTO Agreement on Agriculture.

Although the WTO rulings and recommendations in the cotton dispute were limited to particular claims made by Brazil in that case, the reasoning in *Cotton* would suggest that it is desirable to remove the planting flexibility limitations.

Recommended Solution

To ensure that direct payments will be considered to be non-trade distorting green box assistance, the Administration proposes that the provision of the 2002 farm bill that limits planting flexibility on base acres to exclude fruits, vegetables, and wild rice, should be eliminated.

Background

The 2002 farm bill contained a provision limiting planting flexibility to exclude the planting of fruits, vegetables, and wild rice on base acres. Base acres are used to calculate direct and counter-cyclical payments.

U.S. commodity programs, from their inception in the 1930s to the present day, have had some form of acreage or production controls as a component of agricultural policy. These production and acreage control programs have served two purposes. Primarily, they were an attempt to balance supply and demand. The secondary purpose was to reduce government payments and limit the amount of acreage eligible for payment.

In the United States, interest in more market-oriented programs and global trade liberalization under multilateral trade agreements have prompted policy makers to design and implement less distorting government programs. Beginning with the 1985 farm bill, acreage limitations have gradually been eliminated and replaced by increased planting flexibility for farmers.

The 1996 farm bill provided producers with broad planting flexibility. Producers no longer were required to plant within restrictive and rigid Government regulations. They no longer had to produce a specific crop to receive program benefits and could make planting decisions based on market signals and what was in their best economic interest. The 1996 farm bill singled out fruits and vegetables as the exception to planting flexibility.

The 2002 farm bill continued the exception and added wild rice. Planting fruits, vegetables (other than lentils, mung beans, and dry peas), or wild rice on base acres makes the producer ineligible for direct and counter-cyclical payments. Exceptions include regions with a history of double cropping fruits, vegetables, and wild rice with commodities eligible for direct and counter-cyclical payments, farms with a history of planting fruits, vegetables, and wild rice (with an acre for acre reduction in payments), and producers with a history of planting fruits, vegetables, and wild rice (with an acre for acre reduction in payments).

RETIRE CROP BASES WHEN CROPLAND IS SOLD FOR NON-AGRICULTURAL USES

Recommendation In Brief

Reduce or eliminate crop bases when an entire farm or a portion of a farm is sold for non-agricultural uses.

Problem

There are several situations in which a farmer may sell an entire farm or a portion of a farm with no reduction in crop acreage bases and no reduction in direct and counter-cyclical payments. For instance, a farmer with two farms may sell one of the farms for non-agricultural uses and transfer the crop bases from the farm being sold to the remaining farm. In this instance, the crop bases on the farm being sold may be assigned to the farm being retained if the sum of the crop bases on the two farms is less than total cropland on the farm that is being retained. If a farmer sells a portion of an existing farm, the crop bases on the farm are not reduced unless the sum of the crop acreage bases on the farm exceeds the total cropland on the farm following the sale. In these situations, a producer could sell a major portion or an entire farm for non-agricultural uses with no reduction in direct and counter-cyclical payments. This could permit a producer to continue to receive the same level of direct and counter-cyclical payments even though the remaining cropland on the farm was significantly reduced. Additionally, the retention of crop acreage bases may contribute to the inflation of farmland values, making it harder for beginning and limited resource farmers to purchase land.

Recommended Solution

The Administration proposes to permanently reduce crop acreage bases in proportion to the decline in cropland when a portion of an existing farm is sold for non-agricultural uses. This recommendation also would prohibit reassignment of crop acreage bases to another farm or farms when an entire farm is sold. This proposal is modeled after the mechanism that proportionally reduces program crop base acres when a portion of a farm is enrolled in the Conservation Reserve Program.

Consider a farm with 100 acres of cropland and 60 acres of crop base. Under current law, if that farmer sells 20 acres to development of a subdivision and 20 acres to build a golf course, the farmer would retain the same amount of direct and counter-cyclical payments as before the sale. Under the Administration’s proposal, that same farmer would see a proportional reduction in their base acres and a subsequent reduction in direct and counter-cyclical payments. Thus, in this case, the farmer started with 60 base acres and sold 40 percent of the farm to non-agricultural use; the farmer would receive a 40 percent reduction in base (60 acres multiplied by 40 percent equals a 24 acre reduction) and a proportional reduction in direct and counter-cyclical payments of 40 percent.

Background

Under the 2002 Farm Bill, direct and counter-cyclical payments for program crops are determined by multiplying a prescribed payment rate by payment production. Payment production for a program crop equals 85 percent of a farm’s base acres times the farm’s program yield. Therefore, the amount of direct and counter-cyclical payments a producer is eligible to receive is directly tied to the program crop base acres on the producer’s farming operations. Program crop base acres are determined by land’s previous planting history.

CONSERVATION ENHANCED PAYMENT OPTION

Recommendation In Brief

Offer program crop producers a "conservation enhanced payment option" that enables them to elect to receive an enhanced, guaranteed direct payment if they agree to meet certain conservation requirements and forgo marketing assistance loan program benefits and counter-cyclical program payments. This new program is expected to pay farmers an additional $50 million over the next ten years.

Problem

Farm programs may provide incentives for some producers to grow crops even on drought-prone, marginal lands. Intensive production of program crops on marginal lands is counter to natural resource conservation goals. Moreover, a fixed, direct "green" payment, if properly constructed, would meet World Trade Organization (WTO) rules for non-trade distorting support that is exempt from WTO disciplines. Such incentives must be completely decoupled from current production and prices and must have clearly defined eligibility criteria in order to qualify under WTO rules as "green box" decoupled income support.

Recommended Solution

The Administration proposes to offer producers with program crop base acreage a "conservation enhanced payment option" that would allow producers to receive an enhanced direct payment in place of marketing assistance loan program benefits and counter-cyclical payments. The annual direct payment level for farmers choosing this option would be their regular direct payment provided under provisions of the 2007 farm bill plus ten percent of that payment for the duration of the 2007 farm bill. The direct payment limit for farmers choosing this option would be increased by ten percent as well from $110,000 to $121,000 annually.

Producers who choose this option would be required to adopt conservation and environmental practices equivalent to the Progressive Tier (for more information on the Progressive Tier, see proposal entitled "Conservation Security Program" on pages 46-48) requirements under the Conservation Security Program (CSP). Producers would not be required to produce agricultural commodities to receive the direct payment.

Background

Under this recommendation, a producer with crop acreage base could elect to enter a long-term contract covering the life of the 2007 farm bill to forgo benefits of the marketing assistance loan and the counter-cyclical payment programs. The contract would require the producer to meet the conservation requirements of the Progressive Tier under the CSP. Under the Progressive Tier, the producer must address water and soil quality concerns to a sustainable level and agree to address a third resource concern to a sustainable level by the end of the five-year contract. Similar to other conservation compliance requirements, producers would self-certify compliance with the Progressive Tier and would be subject to audit.

The participating producer would receive an annual, fixed, direct payment in lieu of marketing assistance loan program benefits and counter-cyclical payments. In addition, the producer would continue to receive the direct payment now provided under the 2002 farm bill. This direct payment along with the new "conservation enhanced payment option" direct payment would be subject to a payment limit of $121,000 annually. The producer would also be subject to other payment limit changes and adjusted gross income changes recommended for the 2007 farm bill. [See Title I recommendation entitled "Strengthen Payment and Eligibility Limits" on pages 21-23.]

Example conservation enhanced payment rates under this proposal will be as follows (calculated as 1.1 times the proposed direct payment rates and data are rounded):

Commodity	Proposed Direct Payment Rate 2008-2009 2013-2017	Conservation Enhanced Payment Rate 2008-2009 2013-2017	Proposed Direct Payment Rate 2010-2012	Conservation Enhanced Payment Rate 2010-2012
Barley (bu.)	$0.25	$0.28	$0.26	$0.29
Corn (bu)	$0.28	$0.31	$0.30	$0.33
Grain Sorghum (bu)	$0.35	$0.39	$0.37	$0.41
Oats (bu)	$0.02	$0.02	$0.03	$0.03
Other Oilseeds (cwt)	$0.80	$0.88	$0.86	$0.95
Peanuts (ton)	$36.00	$39.60	$38.61	$42.47
Rice (cwt)	$2.35	$2.59	$2.52	$2.77
Soybeans (bu)	$0.47	$0.52	$0.50	$0.55
Upland Cotton (lb)	$0.11	$0.12	$0.11	$0.12
Wheat (bu)	$0.52	$0.57	$0.56	$0.62

For each commodity, the direct payment for each crop year equals 85 percent of the farm's base acreage *times* the farm's direct payment yield *times* the direct payment rate.

To ensure that the payments are considered non-trade distorting under WTO criteria, the payments should be structured to meet the criteria of decoupled income support. The payments should be fixed and independent of current production and price and the producer should not be required to produce in order to receive the payment.

CONTINUING WTO COMPLIANCE

Recommendation In Brief

Update Section 1601(e) of the 2002 farm bill entitled “Adjustment Authority Related to the Uruguay Round Compliance” to allow USDA to adjust certain payments to meet current and future World Trade Organization (WTO) commitments.

Problem

The 2002 farm bill contains a "circuit breaker" provision that provides the Secretary of Agriculture with the authority to adjust expenditures under certain domestic support programs to ensure that expenditures do not exceed total allowable domestic support limits under the Uruguay Round Agreements. Section 1601(e) of the Act states:

> “If the Secretary determines that expenditures under subtitles A through E that are subject to the total allowable domestic support levels under the Uruguay Round Agreements ... will exceed such allowable levels for any applicable reporting period, *the Secretary shall*, to the maximum extent practicable, *make adjustments* in the amount of such expenditures during that period *to ensure that such expenditures do not exceed such allowable levels*." (emphasis added)

Under Title I, entitled "Commodity Programs,” Subtitles A through E deal with direct and counter-cyclical payments for covered commodities, marketing assistance loans and loan deficiency payments for loan commodities and specific program payments for peanuts, sugar and dairy.

With the potential of a Doha agreement on the horizon, this statutory provision, while a useful tool, has become outdated. Since the current law provision is tied to the Uruguay Round Agreement, USDA would have no mechanism to ensure compliance with a Doha agreement. The ultimate goal is to replace the Uruguay Round Agreements with new agreements that open markets and integrate the global economy through measures such as the reduction or elimination of trade-distorting agricultural subsidies and tariffs. Current law suffers from the defect of being tied directly to the Uruguay Round Agreements, which we hope to supersede with Doha or another such agreement.

Recommended Solution

Section 1601 of the 2002 farm bill should be repealed and the following provision enacted:

“(e) *Adjustment Authority Related to World Trade Organization Agreements Compliance*.

> (1) *Required Determination; Adjustment*. -- If the Secretary determines that expenditures subject to the total allowable domestic support levels under the Uruguay Round Agreements, or any successor agreements, will exceed such allowable levels for any applicable reporting period, the

Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures to ensure that such expenditures do not exceed allowable levels.
(2) *Successor Agreements*. -- For purposes of this subsection, "Uruguay Round Agreements" shall have the meaning prescribed by Section 2 of the Uruguay Round Agreements Act (19 U.S.C. 3501) and "successor agreements" shall refer to any future agreements concluded under the auspices of the World Trade Organization, duly approved by Congress, and determined by the President to be a successor agreement entered into force."

This proposed provision would permit the circuit breaker provision to be available with respect to any future WTO agreement limits and would not be confined solely to those applicable under the Uruguay Round Agreements.

In addition, the current law circuit breaker ties both the determination of allowable levels of domestic support and the expenditures that may be adjusted solely to those expenditures under subtitles A through E of the 2002 farm bill. Other domestic support measures, however, may be properly included in any calculation of total amber box support. The proposed amendment would accommodate their inclusion for all aspects of the circuit breaker determinations.

Background

In 1994, the member states of the WTO entered into a series of trade agreements known as the Uruguay Round Agreements. With respect to agriculture, the agreements sought to reduce subsidies and other market-distorting practices. Since the Uruguay Round Agreements do not themselves have the force of domestic law in the United States, Congress enacted the Uruguay Round Agreements Act to implement the obligations undertaken by the United States.

The agreements provided rules and disciplines for agricultural trade in three principal areas: market access, export subsidies, and domestic support measures. With respect to domestic support, each country agreed to a maximum amount of trade-distorting domestic support it would provide annually. The Uruguay Round Agreement on Agriculture established criteria to differentiate among policies that distort trade ("amber box measures"), policies that do not distort trade ("green box measures"), and direct payments that meet certain production-limiting requirements ("blue box measures").

Under Uruguay Round Agreements, WTO members are required to limit their annual expenditures on "amber box" measures. Each member nation has a different amber box limit, calculated from a historical basis for that country. With a significant exception for measures qualifying as *de minimis* support, the annual limit for the United States is $19.1 billion. Among U.S. programs, marketing loan gains, counter-cyclical payments, the dairy support program, and sugar policy are examples of "amber box" measures.

Recognizing that, under certain market conditions in a given year, U.S. domestic support programs could result in expenditures greater than the amount permitted under the Uruguay Round Agreements, Congress enacted the so-called "circuit breaker" provision in the 2002 farm bill. This provision provides the Secretary of Agriculture with the authority to adjust expenditures under certain domestic support programs to ensure that expenditures do not exceed total allowable domestic support limits.