

Chapter 1

Overview of Payments and Payment Limitations

Federal assistance to crop producers through price and income support programs began when Congress passed the Agricultural Adjustment Act of 1933, one of the first pieces of New Deal legislation. Since then, Congress has frequently created new farm price and income support programs in response to changing conditions in commodity markets, the financial condition of producers, Federal budgetary pressures, and shifts in farm policy goals.

Farm Program and Payment Limit Policy Goals

There are fundamental differences of opinion on whether the amount of Federal assistance a crop producer receives through price and income support programs should be limited, and if limited, at what level. The Commission on the Application of Payment Limitations for Agriculture (Commission) believes these differences of opinion reflect a lack of consensus on the goals of farm price and income support programs. For example, someone who believes that farm programs should provide producers with a minimum price on all production may have a different view of further payment limitations than someone who believes farm programs should help producers achieve a minimum level of income. Therefore, it is important to begin this study on the potential impacts of further payment limitations with a brief discussion of the range of goals of farm price and income support programs.

While authorizing legislation, such as the Farm Security and Rural Investment Act of 2002 (2002 Act), does not generally indicate the goals of farm price and income support programs, some goals have had enduring, although changing, effects on the evolution of farm programs. Primary goals include:

- **Foster an abundant supply of food and fiber**

This goal was evident as far back as the creation of the Nation's land settlement programs and the establishment of the land grant university system, and is sometimes referred to as a "cheap food" policy. It posits that without support, widely fluctuating prices and income would cause farmers to reduce production, leading to higher food prices. The "abundant supply" goal is also sometimes advanced as enhancing national security, because government support encourages domestic production and helps preserve the infrastructure necessary to process food and fiber. Furthermore, the programs may promote a wider geographic dispersion of production, helping to ensure an adequate supply when production falters in some areas. The "abundant supply" goal may extend beyond our borders, striving to enable the United States to be a consistent supplier to international markets and to respond to world food needs.

- **Support and stabilize farm income**

Government intervention to support and stabilize farm income began with the Depression in the 1930s and has continued to the present. Over time, programs to implement this goal have evolved from supporting market prices and controlling production to subsidized crop insurance and farm program payments, with the bulk of the payments being inde-

pendent of production (decoupled). Proponents of this goal point out that demand and supply for agricultural products are quite insensitive to changes in market prices (inelastic), and coupled with the effects of weather, would lead to large swings in farm prices and incomes in the absence of farm price and income support programs.

- **Help producers get access to credit**

The economic stability provided by farm programs enhances the ability of farmers to acquire the credit they need to run their operations. In the absence of farm price and income support programs, the risks associated with farming would increase and this increased risk would likely be reflected in reduced credit availability and higher interest rates for farm operating and real estate loans.

- **Expand agricultural exports**

Increased attention to this goal since the 1970s prompted the move away from farm policies that could reduce U.S. agriculture's ability to compete in world markets. It was the major factor in the shift away from production controls and effective price supports to payments to producers.

- **Conserve natural resources**

Conservation has been a farm program goal since the Dust Bowl of the 1930s.

Conservation programs include retiring fragile land from production as well as lessening the environmental impacts of land remaining in production. Beginning with the Food Security Act of 1985, producers may lose eligibility for farm program benefits if they produce crops on highly erodible land or on converted wetland.

- **Maintain the family farm and the vitality of rural communities**

Maintaining the family farm, including limiting the decline in farm numbers, has been espoused for reasons ranging from preservation of the Nation's agrarian heritage to maintaining economic vitality and infrastructure in rural communities. Some also argue that fewer farms lead to rural outmigration and increased unemployment and pressure on social services in urban areas.

- **Capitalize on the multiple functions of agriculture**

Increasingly, policy discussion has focused on a broader role that agriculture is now viewed as playing, such as supporting economic activity in rural areas, providing open space, protecting the environment, preserving production capacity for future generations, providing recreational and tourist benefits, and providing renewable sources for nonfood products.

- **Counter the protection provided to agriculture in other countries**

It is often argued that other countries protect their farmers and these protections put U.S. farmers at a competitive disadvantage. As a result, farm price and income support programs merely put U.S. farmers on a "level playing field."

Each of these goals has proponents and opponents, yet they remain driving forces in the continuation of farm programs. When the notion of payment limits is presented in the context of these goals, it is easy to see how conflicting views emerge. Those who view abundant farm production or increasing exports as primary goals of farm programs may well argue that there should be no payment limits at all, as any limits, if they are effective, might curtail production and therefore exports as well. In contrast, those feeling that maintaining the family farm and the vitality of rural communities are primary goals may argue there should be limits on payments if they believe that farm programs lead to diminishing farm numbers and a larger average size for the remaining farms, which could reduce economic activity in rural areas.

The primary goals advanced for placing limits on the amount of payments and other benefits a producer may receive under farm price and income support programs include:

- **Reduce government spending**

Reducing the cost of farm price and income support programs has been one factor behind the interest in further payment limits. Spending on farm price and income support programs decreased in fiscal year (FY 2002). However, based on USDA's FY 2004 President's Budget baseline, the cost of farm price and income support programs is projected to increase as a return to normal weather leads to increased crop production and lower prices. In addition, the return of large Federal budget deficits has heightened attention on trimming Federal spending, including lowering the cost of farm programs.

- **Prevent large operators from receiving excessive support**

Those expressing this goal see the primary objective of farm programs as income support and believe that very large operators generally have higher incomes (due to greater efficiency and production) and deeper pockets (more wealth) than smaller operators and therefore are in less need of government assistance.

- **Prevent wealthy non-producers from receiving payments**

Some wealthy individuals who do not depend on farming for their livelihood may qualify for farm price and income support benefits because they own farmland. Many argue that such individuals should be ineligible for farm program benefits.

- **Slow down farm consolidation and the bidding up of land values**

Those expressing this view generally see maintaining the family farm as a primary program goal. This view of payment limits rests on the argument that very large operators have lower costs than smaller farms, and government payments add enough to their net returns to enable them to buy out farms that are in a less advantageous position.

- **Redistribute agricultural program spending**

Proponents of this goal do not necessarily believe that too much is being spent on agricultural programs, but feel that some of that spending should be redirected. They could, for instance, believe that too much is spent on programs that directly support farm prices and incomes and that some of those funds would have a greater public benefit if spent on programs that help farmers to care for the environment.

This study does not address the merits of the array of goals ascribed to farm programs and payment limits. This study does present the views of the Commission on the effects of further payment limitations. The information provided should help Members of Congress and others decide whether further payment limits support or detract from the achievement of their goals for farm policy.

Farm Programs Considered by the Commission

This section reviews the operation of the three farm programs considered by the Commission: direct payments, counter-cyclical payments, and marketing assistance loans. These three programs were authorized by the Farm Security and Rural Investment Act of 2002 (2002 Act), which covers the 2002-07 crops. Examining what causes a farmer's payments from the three programs to rise or fall reveals what circumstances could cause a farmer's payments to be affected by payment limits.

Direct payments and counter-cyclical payments use "base acres" in the payment calculation. Base acres are historical averages of acres dedicated to crops eligible for farm program payments. A farm may have base acres of just one or multiple commodities. Farmers with base acres of wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, peanuts, or other oilseeds are eligible for direct and counter-cyclical payments. Producers need not grow any specific crop on their farm to be eligible for payments, but they must continue to use acres equal to their base acreage in agricultural or conserving uses.

Direct Payments

The direct payments program provides participating farmers with a predetermined payment each year. The direct payment calculation uses the "direct payment yield." As with base acres, that yield is an historic farm average. Additionally, the calculation uses the "direct payment rate," which varies by commodity and is set by the 2002 Act for the 2002-07 crops.

For each commodity, the quantity eligible for a direct payment or "direct payment quantity" is 85 percent of base acreage of that commodity times the direct payment yield. The direct payment for each commodity is the direct payment quantity times the direct payment rate. Nothing in the direct payment calculation depends on the outcome of the 2002-07 growing seasons (prices, yields, etc.), so producers know beforehand if payments will be affected by

the limit on direct payments. Farm characteristics that contribute to payments being affected by the payment limit for this program include the base acres, direct payment yields, and direct payment rates for the crops eligible for direct payments.

Example: Calculating the direct payment

A farmer’s entire base acreage consists of 100 corn base acres, the corn direct payment yield for the farm is 100 bushels an acre, and the direct payment rate for corn is \$0.28 per bushel. The farmer plants 50 acres to soybeans, 40 to corn, and leaves the remainder fallow. The farmer’s direct payment would be \$2,380 (100 corn base acres times 0.85 times 100 bushels per acre times the corn direct payment rate of \$0.28 equals \$2,380). Note that the crop mix has no effect on the payment calculation.

The direct payments program succeeded the production flexibility contract (PFC) payment program that was authorized by the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act). The PFC payments program operated almost identically to the direct payments program. The payment calculation was the same, although the 2001 payment rates were slightly lower than the direct payment rates (table 1.1), and some farmers have since updated their base acres. Another difference was that there was no payment for soybeans, other oilseeds, or peanuts. Because of the similarity of the two programs, this report often uses historical data from the PFC program to provide insight on how payment limits might affect the direct payments program.

Table 1.1. Comparison of payment rates for the production flexibility contract and direct payments programs

Crop	Unit	Production flexibility contract payment rate	Direct payment rate
		2001 crop	2002-07 crops
		Dollars per unit	
Wheat	bushel	0.47	0.52
Corn	bushel	0.27	0.28
Grain sorghum	bushel	0.32	0.35
Barley	bushel	0.21	0.24
Oats	bushel	0.022	0.024
Upland cotton	pound	0.0599	0.0667
Rice	hundredweight	2.10	2.35
Soybeans	bushel	n.a.	0.44
Other oilseeds ¹	bushel	n.a.	0.008
Peanuts	ton	n.a.	36.00

n.a. = Not applicable.

¹ Sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, and sesame seed.

Counter-Cyclical Payments

In addition to base acres, the counter-cyclical payment calculation has four components:

Counter-cyclical payment yield

For some farms, this historic average yield will be different than the direct payment yield. That is because the 2002 Act provided producers who updated bases the opportunity to partially update counter-cyclical yields based on yield history during 1998-2001, an opportunity not provided for direct payment yields.

Effective price

The effective price is defined as the direct payment rate for a commodity plus the higher of that commodity's national average loan rate or the U.S. season-average price received by producers.

Target price

The 2002 Act establishes target prices for eligible commodities (table 1.2).

Counter-cyclical payment rate

If the target price exceeds the effective price for the commodity, the counter-cyclical payment rate equals the difference between the target price and the effective price, otherwise the counter-cyclical payment rate equals zero for the commodity.

Counter-cyclical payments are available only when the target price exceeds the effective price. For each commodity, the quantity eligible for a counter-cyclical payment or "counter-cyclical payment quantity" is 85 percent of base acreage of that commodity times the counter-cyclical payment yield. The counter-cyclical payment for each commodity is the counter-cyclical payment quantity times the counter-cyclical payment rate.

Example: Calculating the counter-cyclical payment

A farmer's entire base acreage consists of 100 corn base acres. The farmer plants 50 acres to soybeans, 40 to corn, and leaves the remainder fallow. The farm's corn counter-cyclical payment yield is 110 bushels an acre and the national average corn loan rate is \$1.98 per bushel. The season-average price of corn is below the national average loan rate. Therefore, the effective price equals \$1.98 plus the corn direct payment rate of \$0.28 or \$2.26 per bushel. The corn counter-cyclical payment rate would be \$0.34 (\$2.60 corn target price minus \$2.26 effective price). The farmer's counter-cyclical payment for corn is \$3,179 (100 corn base acres times 0.85 times 110 bushels per acre counter-cyclical payment yield times \$0.34 corn counter-cyclical payment rate).

Since counter-cyclical payments depend in part on current market prices, farmers will be more likely to reach the limit on counter-cyclical payments in years when high production or weak demand pushes prices down. As with direct payments, farm characteristics can also affect whether counter-cyclical payments will be affected by payment limits. These characteristics include the base acres and payment yields for the crops eligible for counter-cyclical payments.

Table 1.2. Target prices for the counter-cyclical payment program

Crop	Unit	2002-03 crops	2004-07 crops
		Dollars per unit	
Wheat	bushel	3.86	3.92
Corn	bushel	2.60	2.63
Grain sorghum	bushel	2.54	2.57
Barley	bushel	2.21	2.24
Oats	bushel	1.40	1.44
Upland cotton	pound	0.724	0.724
Rice	hundredweight	10.50	10.50
Soybeans	bushel	5.80	5.80
Other oilseeds¹	pound	0.098	0.101
Peanuts	ton	495.00	495.00

¹ Sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, and sesame seed.

Marketing Assistance Loans

Farmers are eligible for marketing assistance loans when they harvest wheat, corn, grain sorghum, barley, oats, upland cotton, extra long staple cotton, rice, soybeans, other oilseeds, dry peas, lentils, small chickpeas, or peanuts. Wool, mohair, and honey are also eligible. To participate, farmers decide how much of their current year's production they want a loan on and pledge that amount as collateral.

Farmers can use marketing assistance loan funds for immediate needs, including paying debts and living expenses, which reduces pressure to market commodities immediately at harvest, a time when prices may be at their lowest. This can enable producers to wait until prices have improved to settle their loans and market their commodities.

Marketing assistance loans have a 9-month maturity and accrue interest. For simplicity, however, the examples assume marketing assistance loans do not accrue interest. The loans may be repaid at any time prior to maturity. These loans are “nonrecourse loans” meaning that the government must accept the collateral as full payment of the loan at loan maturity if a producer so chooses. A national loan rate per unit of collateral is set by the 2002 Act for each eligible commodity (table 1.3). For some commodities, USDA uses the national loan rate as a starting point for setting county loan rates, which reflect local variations in commodity prices.

Farmers can receive benefits from marketing assistance loans in four ways, two of which are now subject to payment limits. Each is detailed below. Extra long staple cotton is eligible for only the fourth type of benefit.

Table 1.3. National marketing assistance loan rates

Crop	Unit	2001 crop	2002-03 crops	2004-07 crops
		Dollars per unit		
Wheat	bushel	2.58	2.80	2.75
Corn	bushel	1.89	1.98	1.95
Grain sorghum	bushel	1.71	1.98	1.95
Barley	bushel	1.65	1.88	1.85
Oats	bushel	1.21	1.35	1.33
Upland cotton	pound	0.5192	0.52	0.52
Rice	hundredweight	6.50	6.50	6.50
Soybeans	bushel	5.26	5.00	5.00
Other oilseeds¹	pound	0.093	0.096	0.093
Dry peas	hundredweight	n.a.	6.33	6.22
Lentils	hundredweight	n.a.	11.94	11.72
Small chickpeas	hundredweight	n.a.	7.56	7.43
Peanuts	ton	n.a.	355.00	355.00
Graded wool	pound	n.a.	1.00	1.00
Nongraded wool	pound	n.a.	0.40	0.40
Mohair	pound	n.a.	4.20	4.20
Honey	pound	n.a.	0.60	0.60

n.a. = Not applicable.

¹ Sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, and sesame seed.

1. Marketing loan gains (MLGs)

Producers may repay a marketing assistance loan anytime before loan maturity at the alternative loan repayment rate announced by USDA, if the alternative rate is less than the loan rate plus accrued interest. The alternative repayment rates for upland cotton and rice are announced weekly and are commonly called “adjusted world prices” (AWPs). For most other crops, the alternative repayment rates are announced daily and are commonly called “posted county prices” (PCPs). These alternative repayment rates rise when market prices rise and decline when market prices decline.

The gain realized by the producer from repaying less than the loan principal to settle the loan is called a marketing loan gain. Marketing loan gains currently have a joint payment limit with loan deficiency payments, which are discussed in the following section.

Example: Calculating the marketing loan gain

A farmer produces 10,000 bushels of corn and pledges all of it as collateral for a marketing assistance loan. At a loan rate of \$1.98 per bushel, the farmer receives \$19,800 in loan proceeds (\$1.98 loan rate times 10,000 bushels equals \$19,800). Suppose the farmer settles the loan for \$18,000 on a day when the PCP is \$1.80 per bushel (\$1.80 times 10,000 bushels equals \$18,000). The marketing loan gain would be \$1,800 (\$19,800 loan principal minus \$18,000 equals \$1,800).

2. Loan deficiency payments (LDPs)

These payments are similar to MLGs, with the key difference being that farmers receive LDPs on current production not placed under loan. The loan deficiency payment rate is the amount by which the loan rate exceeds the alternative repayment rate on the day the farmer requests payment. The total loan deficiency payment is the payment rate times the quantity of a commodity for which a producer requests a loan deficiency payment.

Example: Calculating the loan deficiency payment

Let’s revisit the farmer who produced 10,000 bushels of corn. Rather than placing the corn under loan, that farmer might want to receive an LDP and either market the 10,000 bushels of corn or hold the crop and wait to see if the market price increases. If the PCP is \$1.80 per bushel on the day the farmer wishes to receive the LDP prior to the marketing of the corn, the loan deficiency payment rate would be \$0.18 per bushel (\$1.98 loan rate minus \$1.80 equals \$0.18). On that day, the operator would receive an LDP of \$1,800 (\$0.18 payment rate times 10,000 bushels equals \$1,800).

3. Gains from the certificate exchange process

In addition to repayment of the marketing assistance loan, commodity certificate exchanges are another way for farmers to reestablish unencumbered control of their loan collateral. The exchange process involves three sequential steps and begins with the producer taking out a marketing assistance loan. Next, the producer turns the collateral over to the Commodity Credit Corporation (CCC) in full satisfaction of the loan and purchases certificates from the CCC. The certificate’s unit price is the alternative loan repayment rate for the commodity (PCP or AWP) at the time of the certificate purchase. Lastly, the producer exchanges the certificates for the quantity of the commodity that was previously under loan and regains control of the collateral.

When the cost of the certificate used to reacquire ownership of collateral is less than the loan principal that was secured by that collateral, the farmer achieves a certificate exchange gain. There is no payment limit on certificate exchange gains.

Example: Settling a marketing assistance loan with commodity certificates

A farmer pledges 10,000 bushels of corn as collateral for a marketing assistance loan and receives \$19,800 in loan funds (\$1.98 per bushel loan rate times 10,000 bushels of corn equals \$19,800). Let's assume the farmer opts to use certificates to settle the loan. On the day the farmer settles the loan, the PCP is \$1.80 and the farmer purchases \$18,000 worth of commodity certificates (\$1.80 PCP times 10,000 bushels equals \$18,000). The farmer then exchanges the certificates to obtain the collateral previously placed under loan. The farmer's certificate exchange gain would be \$1,800 (\$19,800 loan principal retained by the producer minus the \$18,000 certificate cost equals \$1,800).

4. Forfeiture gains

Producers may settle marketing assistance loans by forfeiting ownership of the loan collateral to the government when the loan reaches maturity. The farmer benefits if the market value of collateral forfeited is less than the loan balance; such a benefit is defined as a forfeiture gain. There is no limit on forfeiture gains.

Example: Settling a marketing assistance loan by forfeiture

A farmer pledges 10,000 bushels of corn as collateral for a marketing assistance loan and receives \$19,800 in loan funds. When the loan is due, the farmer decides to forfeit the collateral to the CCC rather than repay the loan. On the day of forfeiture the PCP is \$1.80 so the collateral has an estimated market value of \$18,000 (\$1.80 PCP times 10,000 bushels equals \$18,000). The forfeiture gain would be \$1,800 (\$19,800 loan proceeds minus \$18,000 collateral value equals \$1,800).

Marketing loan gains and loan deficiency payments are subject to payment limits under the 2002 Act, while payment limits do not apply to certificate exchange gains and forfeiture gains. Since some types of marketing assistance loan benefits are not subject to payment limits, the 2002 Act does not restrict the overall amount of marketing loan benefits any producer may receive.

Marketing loan gains, loan deficiency payments, certificate exchange gains, and forfeiture gains all depend on current prices and current production. As a result, marketing loan benefits rise as market prices decline helping to stabilize farm income. If total marketing loan benefits were subject to payment limits, farmers would more likely reach the limit on benefits in years when high production or weak demand pushes prices down. Farm characteristics that would also contribute to reaching a limit on marketing loan benefits include the amount of acreage harvested and the yield per harvested acre of commodities eligible for marketing assistance loans.

The Development of Payment Limits Through 2001

Changes in farm programs during the 1960s, such as the introduction of direct payments, were important first steps toward a market-oriented agriculture. However, direct payment program costs were large and visible. In addition, attention focused on the distribution of program benefits, which showed some farmers receiving in excess of \$1 million. In reaction, Congress passed the first legislation to limit payments to producers in 1970.

In the Agricultural Act of 1970 (1970 Act), Congress mandated payment limits for farm programs designed to assist crop producers. The 1970 Act set three separate \$55,000 limits: one each for payments related to wheat, feed grains, and upland cotton. Farmers growing all three crops could have received up to \$165,000 in farm program payments. The limit applied to land diversion payments, wheat certificate payments, and other payments on the basis of parity prices in use at that time.

The Agriculture and Consumer Protection Act of 1973 (1973 Act) introduced the concept of target prices and deficiency payments for wheat, feed grains, and upland cotton. The 1973 Act established an annual per-person limit of \$20,000 for combined payments for the 1974-77 crops of wheat, feed grains, and upland cotton. Payments subject to the per-person limit included deficiency, diversion, and disaster payments. In subsequent legislation, the Congress excluded disaster payments from the payment limit for the 1977 crop. The Rice Production Act of 1975 established deficiency payments for rice and a \$55,000-per-person limit on payments for rice in 1976 and 1977. From 1979 through 1995, wheat, feed grain, upland cotton, and rice deficiency and diversion payments were subject to an annual per-person limit for all crops combined of \$50,000.

Another major step toward a market-oriented agriculture occurred in the mid-1980s. During the mid-1980s, exports stagnated and concern arose that the nonrecourse price support program was reducing the competitiveness of U.S. crops in world markets by establishing a floor on U.S. prices for wheat, feed grains, upland cotton, and rice. The Food Security Act of 1985 (1985 Act) introduced the concept of marketing loans in which producers could repay nonrecourse price support loans at less than the loan rate when the market or world price was below the loan rate. The 1985 Act did not place a limit on marketing loan benefits. However, Congress amended the 1985 Act in 1986, establishing a new combined limit of \$250,000 on a wide range of farm program payments, including loan deficiency payments and marketing loan gains. The Food, Agriculture, Conservation, and Trade Act of 1990 (1990 Act) included marketing loan gains and loan deficiency payments in a group of payments that were subject to an annual per-person limit for all crops combined of \$75,000. Under the 1996 Act, loan deficiency payments and marketing loan gains for all crops were subject to a combined limit of \$75,000 and PFC payments for all crops were limited to \$40,000. When crop prices declined sharply in the late 1990s, Congress increased the combined limit on loan deficiency payments and marketing loan gains to \$150,000 for the 1999 through 2001 crops.

Payment Limits on the Programs Considered by the Commission

Payment limits for the three farm programs considered by the Commission are set by the 2002 Act. They apply to “persons,” that is, each “person” has a separate payment limit. A person may be an individual (human being) or it may be an entity used by a producer as a way to organize the farm business, such as a corporation. Table 1.4 presents the three per-person payment limits for the farm programs considered by the Commission. The next chapter provides a fuller treatment of “persons” and other payment limit administrative issues.

Table 1.4. Current payment limitations for direct and counter-cyclical payments and marketing assistance loans

Program	Limit
Direct payments	<ul style="list-style-type: none">• \$40,000 total for direct payments for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds (canola, crambe, flaxseed, mustard seed, sunflower seed, safflower, sesame seed)• \$40,000 total for direct payments for peanuts
Counter-cyclical payments	<ul style="list-style-type: none">• \$65,000 total for counter-cyclical payments for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds (canola, crambe, flaxseed, mustard seed, sunflower seed, rapeseed, safflower, sesame seed)• \$65,000 total for counter-cyclical payments for peanuts
Marketing assistance loans	<ul style="list-style-type: none">• \$75,000 total for loan deficiency payments and marketing loan gains for wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, dry peas, lentils, small chickpeas, and other oilseeds (canola, crambe, flaxseed, mustard seed, sunflower seed, rapeseed, safflower, sesame seed)• \$75,000 for loan deficiency payments and marketing loan gains for peanuts, wool, mohair, and honey• No limit on certificate exchange or forfeiture gains

Off-Farm Income and Eligibility for Programs Considered by the Commission

Under the 2002 Act, those whose 3-year average adjusted gross income exceeds \$2.5 million are ineligible for program benefits, unless they can establish that at least 75 percent of their income is derived from farming, ranching, and forestry. The income measure used, adjusted gross income, is a Federal income tax concept. For individuals, adjusted gross income combines earnings from wages and other sources with profits or losses from farming or any other business. Individuals and other forms of businesses are allowed various deductions when calculating adjusted gross income; health insurance expenses for the self-employed is one example.

Payments made to a corporation, general partnership, or joint venture are reduced if any participant in the organization does not meet the adjusted gross income criteria, with the percentage reduction in benefits equaling that participant's ownership interest. Those ineligible for marketing loan gains and loan deficiency payments because of the adjusted gross income restriction can still obtain marketing assistance loans and receive benefits in the form of certificate exchange and forfeiture gains. Data provided to the Commission indicate that a very small number of those previously receiving farm program benefits will become ineligible for direct, counter-cyclical, and loan deficiency payments and marketing loan gains as a result of the adjusted gross income limitation.

Conclusions

- Many objectives of payments have been advanced over time, ranging from ensuring an abundant and affordable supply of food and other farm products to conservation of natural resources to supporting the family farm. The justification for payment limits and the levels at which they are established vary depending on the objectives of the payments. For example, if the objective of payments is to provide general income support to farm households, then payment limits may serve the purpose of halting support after farm household incomes reaches some target level. Alternatively, if the purpose of payments is to ensure or expand aggregate and regionally diversified production by supporting and stabilizing farm income, then payment limits may not be justified because they may discourage production of the directly affected crops. Because people have strongly divergent views on the purpose of payments, people have strongly divergent views on payment limits.
- Payment limits are an increasing public issue today because Federal budget deficits are increasing the pressure to reduce Federal spending and because USDA projects lower farm prices in response to increasing production, raising the cost of farm programs. In addition, opinion on the objectives of farm programs is very diverse and Federal budget resources are in great demand for alternative uses.
- The three payment programs considered by the Commission provide different types of financial support with different objectives. Direct payments provide general income support through a fixed payment dependent on historical acreage and yields. Counter-cyclical payments also depend on historical acreage and yields but increase as prices decline. Benefits from the marketing assistance loan program are the most linked to current conditions, depending on both production and prices, and increase as production rises and prices decline.
- Producers may elect to receive benefits under the marketing loan assistance program in four ways: marketing loan gains, loan deficiency payments, certificate exchange gains, and forfeiture gains. All four ways may provide nearly identical benefits to the producer. Since

only two forms of marketing loan benefits are subject to current payment limits (loan deficiency payments and marketing loan gains), marketing assistance loan benefits are not limited by current payment limitations.

- Each of the three programs considered by the Commission has different limits but are linked through various mechanisms. Therefore, changes in payment limits and payment provisions may be reinforcing or contradictory. For example, if a policy objective is to limit marketing assistance loan benefits, this objective may be achieved by either changing payment limitations for marketing assistance loans or, alternatively, by making changes in the marketing assistance loan program itself, such as lowering loan rates. However, program parameters are closely linked. Lower loan rates would increase maximum counter-cyclical payment rates and potentially raise the number of producers that could have payments reduced because of the limit on counter-cyclical payments, unless target prices were also lowered.
- The specific payment limits established by Congress for each of the three payment programs considered by the Commission have changed over time. It is apparent that Congress has wanted payment limits in place but has also wanted to avoid having the limits be unduly constraining. Increasing the limit on loan deficiency payments and marketing loan gains and permitting producers to use certificates to settle loans at times of low prices are examples of actions taken to prevent payment limits from being too constraining.
- While payment programs have been adjusted over time to reflect economic and equity considerations for individual crops, payment limits generally have been uniformly imposed without regard to the economic structure of commodities or regions.