The 2002 Farm Bill Commodity Support Payments: How Do They Work?

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The 2002 Farm Bill
Commodity Support Payments:
How Do They Work?

Alan May
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The Farm Security and Rural Investment Act of 2002 provides the potential of a three-tier payment system through the commodity support provisions of the farm bill. The commodity support provisions in the new farm bill include:

• the possibility of market loan gains (MLG) from Marketing Assistance Loans and/or Loan Deficiency Payments (LDP),
• Direct "fixed" Payments (DP), and
• Counter-Cyclical Payments (CCP).

Marketing Assistance Loans / LDPs

This provision of the new farm bill will be handled in the same manner as in the 1996 farm bill. The availability of the market loan or the LDP is coupled (tied) to current production and price. Any payment made to a producer in this form is not tied to base acres or base yields.

In other words, a producer could potentially take out a market loan or collect an LDP on every bushel of corn, soybeans, or wheat that he/she produces. Whether this payment is available would also depend on the current price of the commodity, or more specifically, the posted county price in relationship to the county loan rate for a given commodity. An LDP would be available on any given day if the county loan rate is higher than that day’s posted county price. A producer can claim an LDP any day after harvesting the crop and before losing beneficial interest in the commodity. The other alternative for a producer is to take out a marketing loan at harvest, or sometime after harvest, as long as the producer holds beneficial interest in the commodity. When taking out the loan, the producer would receive the loan rate value for the given commodity. The loan can then be repaid before maturity, it can be repaid with generic certificates, or the loan can be held to maturity and forfeited to the government.

For example, if the loan is repaid before maturity and the posted county price is lower than the loan rate, the producer pays back the loan at the posted county price only. The producer keeps the balance as the marketing loan gain (MLG).

How does this payment work? Assume the county loan rate for corn is $1.80/bushel. Assume it is harvest time and the posted county price for corn on the day the corn is harvested is $1.60/bushel. As long as the producer retains beneficial interest in the corn when it is harvested, he/she could claim a $.20/bushel LDP, the difference between the county loan rate and the posted county price.

The other alternative for the producer is to take out the market loan on his/her corn and receive the county loan rate of $1.80/bushel. The producer can store the corn until the loan matures or sell it at a later date prior to maturity. If, at time of sale, the posted county price for corn is still $1.60/bushel, the producer pays back the loan at the $1.60 value and keeps a marketing loan gain of $.20/bushel.
**Marketing Loan Payment**

- County Loan Rate = $1.80
- Posted County Price (PCP) = $1.60
- Loan Def. Payment (LDP) = $0.20

--- OR ---

- Store corn; take Mktg. Loan = $1.80
- Later; sell corn. PCP value = $1.60
- Market loan gain (MLG) = $0.20

**Note:** If the producer repays the loan when the posted county price is higher than the county loan rate, a market loan gain is not available. The producer is required only to pay back the loan at the county loan rate value plus interest.

This process would be the same for other program commodities such as soybeans and wheat. It should also be noted that the loan rates are "locked in" in the farm bill.

The Secretary of Agriculture will not have discretion to raise or lower loan rates from year to year as was the case in the 1996 farm bill.

**Direct (Fixed) Payments**

The direct payment is the only "guaranteed" payment in the 2002 farm bill. This payment is decoupled from price and production. It is very similar to the AMTA payment available in the 1996 farm bill.

This payment will be based on a producer’s base acres and base yields and will not be influenced by the current year’s production or price. Payment is made in the form of cents per bushel as established in the 2002 farm bill. Each commodity has an established payment rate. Those rates are as follows:

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Payment Rate 2002–2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn (bu)</td>
<td>$0.28</td>
</tr>
<tr>
<td>Sorghum (bu)</td>
<td>$0.35</td>
</tr>
<tr>
<td>Barley (bu)</td>
<td>$0.24</td>
</tr>
<tr>
<td>Oats (bu)</td>
<td>$0.024</td>
</tr>
<tr>
<td>Wheat (bu)</td>
<td>$0.52</td>
</tr>
<tr>
<td>Soybeans (bu)</td>
<td>$0.44</td>
</tr>
<tr>
<td>Minor Oilseeds (cwt)</td>
<td>$0.80</td>
</tr>
</tbody>
</table>

The payment rates listed are fixed over the life of the new farm program and will not decline each year. This payment will be made based on the base acres established by the producer as allowed in the 2002 farm bill and the producer’s "old" yields frozen in the 1985 farm bill.

This payment will be made regardless of the level of production each year and regardless of the current price of the commodity. Since this payment is not tied to either current production or price, this becomes the only "guaranteed" payment in the new farm bill.

**Counter-Cyclical Payments**

The third payment established in the commodity support provisions of the 2002 farm bill is the counter-cyclical payment. This payment is almost identical to the target price/deficiency payment system that was a part of farm programs prior to 1996.

Counter-cyclical payments are decoupled from production, but not from price. In other words, if a counter-cyclical payment is available, it will be paid on the base acres and yields established by the producer as allowed in the 2002 farm bill. However, this payment is tied to current prices. National yearly average prices for the program crops will be calculated to determine if counter-cyclical payments are available from year to year. Target prices for the program commodities are established in the 2002 farm bill.

The new farm bill allows for a counter-cyclical payment if the "effective price" of grain is less than the target price. The "effective price" is defined as the Direct Payment plus the higher of the following: the national average loan rate or the national average yearly price. If the "effective price" of the commodity for the current marketing year exceeds the target price, a counter-cyclical payment is not available. If the "effective price" is less than the target price, a counter-cyclical payment becomes available.

The counter-cyclical payment is determined by a formula outlined in the 2002 farm bill. The formula involves the specific commodity target price, the average national loan rate or the average national yearly price of the specific commodity, and the direct payment rate. The formula to calculate the counter-cyclical payment is as follows:

\[
\text{Target price minus (the higher of the national average loan rate or the national average yearly price plus the direct payment)} \quad \text{equals} \quad \text{the counter-cyclical payment.}
\]

Target prices used to calculate counter-cyclical payments are:

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Target Price 2002-03</th>
<th>Target Price 2004-07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn (bu)</td>
<td>$2.60</td>
<td>$2.63</td>
</tr>
<tr>
<td>Sorghum (bu)</td>
<td>$2.54</td>
<td>$2.57</td>
</tr>
<tr>
<td>Barley (bu)</td>
<td>$2.21</td>
<td>$2.24</td>
</tr>
<tr>
<td>Oats (bu)</td>
<td>$1.40</td>
<td>$1.44</td>
</tr>
<tr>
<td>Wheat (bu)</td>
<td>$3.86</td>
<td>$3.92</td>
</tr>
<tr>
<td>Soybeans (bu)</td>
<td>$5.80</td>
<td>$5.80</td>
</tr>
<tr>
<td>Minor Oilseeds (cwt)</td>
<td>$9.80</td>
<td>$10.10</td>
</tr>
</tbody>
</table>
How does this payment work? Assume the corn target price is $2.60/bushel. The national average loan rate for corn is $1.98/bushel. The direct payment for corn is $0.28/bushel. If, at the end of the marketing year, the national average corn loan rate is higher than the national average yearly price for corn, the loan rate value will be used in the calculation. The counter-cyclical payment would be 34 cents as calculated below:

\[
$2.60 - (\$1.98 + \$0.28) = \$0.34 \text{ (ccp/bu)}
\]

This example indicates that a maximum counter-cyclical payment exists. If the national average loan rate is used in the counter-cyclical payment calculation, this will automatically calculate a maximum payment.

On the other hand, if the national average price of corn were $2.28, higher than the national average corn loan rate of $1.98, the counter-cyclical payment would equal 4 cents per bushel based on the following calculation:

\[
$2.60 - (\$2.28 + \$0.28) = \$0.04 \text{ (ccp/bu)}
\]

In this case the "effective price" (the national average price of corn plus the direct payment) does not exceed the target price. This means a counter-cyclical payment is available. However, if the national average price of corn plus the direct payment exceeds the $2.60 target price, no counter-cyclical payment is available.

This same counter-cyclical payment formula applies to other program commodities. Simply use the applicable commodity target prices, direct payment rates, loan rates, and/or average marketing year prices for the specific commodity you wish to evaluate.

**Timing of Payments**

Producers will receive payments at various times of the year. Direct payments for 2002 will be made after program rules and regulations are in place and when practicable.

The first payment for 2002 will probably occur sometime in the fall. This payment will be equal to the calculated direct payment minus the 2002 production flexibility contract payments already made in accordance with the previous farm bill.

Starting in 2003, a producer may receive up to 50% of the direct payment beginning December 1 of the calendar year prior to harvest. The remainder of the direct payment will be made in October of the calendar year of harvest. The chart on the back of this page outlines the timing of direct payments and counter-cyclical payments through the end of 2004.

The timing of counter-cyclical payments depends on the marketing year schedule of each specific commodity. The first partial payment is made in October of the year of harvest. A producer may receive up to 35% of the anticipated counter-cyclical payment at this time.

The second advance payment is available in February of the year following harvest. This payment, when combined with the first partial payment cannot exceed 70% of the projected counter-cyclical payment. The final counter-cyclical payment is made as soon as practicable after the end of the 12-month marketing year for the specific commodity.

There is the possibility that, under certain price fluctuations during the marketing year for a given commodity, over-payment of the counter-cyclical payments may occur. If this should happen, a producer will be required to pay back that portion of his/her advance counter-cyclical payment that exceeds the actual payment he/she is entitled to for that marketing year.

Finally, it must be noted that this publication was written prior to the completion of rules that will regulate the commodity provisions of the new farm bill. While the details presented in this paper are taken directly from the 2002 farm bill legislation, the reader must consult with his/her local Farm Service Agency office to fully understand the rules and regulations that will govern this payment process.
## Direct and Counter-Cyclical Payment Schedule for 2002-2004

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<tbody>
<tr>
<td>Corn</td>
<td></td>
<td></td>
<td>2002 CC 1st Adv.</td>
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<tr>
<td>Soybeans</td>
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<td></td>
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<td>2002 CC 2nd Adv.</td>
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<tr>
<td>Sorghum</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2003 CC Final</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wheat</td>
<td></td>
<td></td>
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<tr>
<td>Barley</td>
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<td></td>
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<td></td>
<td>2003 CC Final</td>
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<tr>
<td>Oats</td>
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</tbody>
</table>

CC: Counter-Cyclical  
DP: Direct Payment  
Adv: Advance  

**Direct Payments:** Producer may opt to take up to 50% of the direct payment in advance.  
**Counter-cyclical payments:** The first counter-cyclical payment may be up to 35% of the projected total CC payment. The sum of the second payment and the first payment may not exceed 70% of the projected total CC payment. The 2002 Farm Bill will require repayment of the amount of the partial payments that exceed the actual counter-cyclical payment to be made for the covered commodity for that crop year.