APAC Agricultural Policy Analysis Center
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PolicyPennings by Dr. Daryll E. Ray

On eliminating the counter cyclical payments

In this third of a series of columns looking at the reasons that might be used to justify the elimination of various components of the current farm program, we want to take a look at the counter-cyclical payments. This examination is triggered by three factors: (1) the persistent call by many for the elimination of agricultural subsidies, primarily in the U.S. and E.U., because these subsidies are said to stimulate overproduction resulting in low prices that harm farmers in less developed countries, (2) President Bush's call for developed countries to eliminate the $112 billion a year that they spend on subsidizing their farmers, and (3) the U.S. budget crisis that puts farm spending at risk.

We are not suggesting that the possibility of getting both the U.S. and the E.U. to eliminate their farm subsidies as a part of the WTO negotiations is very likely, however in late 1995 and early 1996, we did not think that the market oriented reforms of Freedom to Farm had much of a chance of being adopted either.

But for now our approach is very limited. We are only looking at one government payment component of the U.S. farm program at a time - this week its counter-cycle payments - and we are only focusing on arguments that might be used to justify their elimination, separate from other considerations. Thus, we are not considering the overall financial impact of eliminating the farm programs, the probability of such an elimination occurring, or the possible need to replace existing government payment instruments with other programs.

Counter-cyclical income support payment program is a new program with the 2002 Farm Bill. This program was developed to replace most of the ad hoc emergency payments that were made to farmers during 1998-2001 because of unforeseen price declines and yield shortfalls. The CCP payments are based on historical production and are not tied to current production. The covered crops include: wheat, corn, grain sorghum, barley oats, rice, upland cotton, soybeans, other oilseeds and peanuts.

CCPs are paid whenever the effective price is less than the target price. The effective price is calculated by adding the higher of the commodity price or the loan rate to the direct payment rate. The difference between the target price and the effective price is called the payment rate. This payment rate is then multiplied by 85% of the base acres times the payment yield to determine the payment the producer receives. Aside from adjusting for the direct payment rate, the major difference between counter-cyclical payments and the old target price program prior to 1996 is with CCP, the farmer does not have to plant the crop to be eligible for the payment.

The CCPs are paid in three installments: 35% in October of the year when the crop is harvested, 70% less the first payment after February 1, and the final payment as soon after the end of the crop year as is practicable.

Farmers were allowed to keep the base acres they had under the 1996 Farm Bill plus the average oilseed plantings in 1998-2001, so long as the base acres did not exceed available cropland. Or, they were eligible to update base acres to reflect the 4-year average of acres planted, plus those "prevented from planting" due to weather conditions, during the 1998-2001 crop years. The same base acres had to be used for both direct payments and counter-cyclical payments.

For payment yields, farmers had three choices: (1) use the program yields they had under the 1996 Farm Bill, (2) add 70% of the difference between the program yields and the farm's average yields for the period 1998-2001 to the program yields, or (3) update yields to 93.5% of the 1998 average yields.

The payment limit for CCPs is $65,000 per person, per crop year, and the three entity rule is retained. Producers with an adjusted gross income over $2.5 million averaged over 3 years are not eligible for payments, unless more than 75% of their adjusted gross income is from agriculture.

While the direct payments are decoupled from both production and price, the CCPs are only decoupled from production. This is an attractive feature of the CCPs when compared to the direct payments. The direct payments are paid whether prices and farm incomes are high or low, while CCPs are only paid when prices (and presumably farm income) are low.

The CCPs allow farmers to retain planting flexibility with the exception of new plantings of fruits and vegetables. Thus, in a given year, it is possible for a producer to receive CCPs for a particular crop even though they did not plant that crop in the year the CCPs were received.

CCPs reduce farmers' production risk by assuring that they will receive a minimum level of revenue as long as they keep the land in agricultural use (including fallow), and comply with certain conservation and wetland provisions. They also, as intended, eliminate or reduce the need for Congress to appropriate ad-hoc emergency payments to offset depressed prices.

One risk scenario CCPs don't provide protection for is one that may occur this year. If the drought in Illinois, parts of Missouri and surrounding areas results in significant corn production loss in those areas, farmers elsewhere may enjoy higher prices, eliminating the need for corn CCPs. Thus, the drought affected farmers would lose out on both the higher prices and the CCPs.

To the extent that the CCPs, when added to direct payments and market receipts, exceed the cost of production, it can be argued that they contribute to dumping in foreign markets.

CCPs moderate price valleys caused by weather and other random effects on domestic yields and foreign demand. But as is the case with most government payment programs, CCPs do not address aggregate crop agriculture's basic market problem: its ability to "right" itself after being capsized by persistently low prices.

When agriculture's ability to produce grows faster than demand, prices fall. But the low prices do not cause consumers to increase consumption nor farmers to reduce total output produced by very much. Thus, the usual market mechanism that should pull-up crop-wide depressed prices using agriculture's own bootstraps does not work as well or as quickly as it does in other sectors.

Government payment programs, including the counter cyclical payment program don't address the rebalancing of market quantities issue; they only compensate for the low prices after-the-fact.

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