

Commodity Loan Programs— Price Supports and Marketing Loans

Commodity loan programs have operated in two major ways: price support and income support. Commodity loan programs supported market prices over most of their history, starting in 1933. With the more recent introduction of marketing loan provisions, starting in the mid-1980's with rice and upland cotton, commodity loan programs now provide income support to producers but do not support market prices.

Loan Program Operation

Commodity loan programs allow producers of designated crops to receive loans from the government at a crop-specific loan rate per unit of production by pledging production as loan collateral. A farmer may obtain a loan for all or part of a crop at any time following harvest through the following March or the following May, depending on the crop.¹ Most loan placements occur shortly after harvest, when prices tend to be seasonally low, and provide short-term financing to farmers.

For production put under loan and pledged as loan collateral, the farmer receives a per-unit amount equal to that year's loan rate (in the farmer's county) for the crop. Under the loan program, the producer must keep the crop designated as loan collateral in approved storage to preserve the crop's quality. The producer may repay the loan (plus interest) at any time during the 9- to 10-month loan period.

Before marketing loans were introduced (discussed next), the farmer could satisfy the loan by repaying the loan principal plus accrued interest charges. Alternatively, the farmer could choose to settle the loan at the

¹ Generally, farm commodity program participation is a requirement for loan program eligibility. In the past, annual commodity programs for feed grains, wheat, rice, and upland cotton included supply management provisions (such as acreage reduction programs or set-aside programs), and required producers to comply with such provisions to be eligible for program benefits, including the loan program and target-price-based deficiency payments. The 1996 Farm Act eliminated supply management programs, but required farmers of program crops to enroll at least one program crop in the 7-year program to be eligible for program benefits, including production flexibility contract payments and commodity loans (Young and Westcott; Nelson and Schertz). There have been no other program features for oilseeds beyond the loan program, so no program enrollment has been required and all production of oilseeds has been eligible for the loan program.

end of the loan period (loan maturity) by keeping the loan proceeds and forfeiting ownership of the loan collateral (the crop) to the government. If market prices were below the loan rate, the farmer would benefit from settling the loan this way, keeping the higher loan rate. Additionally, if market prices were above the loan rate but below the loan rate plus interest, keeping the loan proceeds and forfeiting the crop to the government would also make economic sense because the cost of repaying the loan plus interest would be greater than the market value of the crop. The loan program provided price support to the sector by the government's acquiring crops through loan program forfeitures which, in combination with Commodity Credit Corporation (CCC) sales price restrictions, essentially removed crops from the marketplace as long as prices remained low.²

Marketing loans were started for rice and upland cotton in 1986 under provisions of the 1985 Farm Act. Subsequent legislation mandated the availability of marketing loans for soybeans and other oilseeds starting in 1991. Marketing loans for wheat and feed grains were implemented starting with 1993 crops, under the General Agreement on Tariffs and Trade (GATT) trigger provisions of the Omnibus Budget Reconciliation Act of 1990. The 1996 Farm Act continued marketing loans for all of these crops. The addition of marketing loan provisions significantly changed the operation of the commodity loan program.

Loan placements under the commodity loan program with marketing loans may occur as described earlier under nonrecourse loan provisions. Marketing loan provisions, however, allow farmers to repay commodity loans at less than the original loan rate (plus interest) when market prices are lower. This feature decreases the loan program's potential effect on supporting prices by reducing the government's accumulation of stocks through forfeitures. Instead, marketing loans provide farmers economic incentives to retain ownership of crops and sell them (hence the term "marketing loan") rather than forfeit ownership of crops to the government to settle loans.

Producers can receive marketing loan benefits through two different channels: the loan program and loan deficiency payments. Under the loan program, farmers place their crop under the commodity loan program, as described earlier, by pledging and storing all or part of

² The 1996 Farm Act removed CCC sales price restrictions.

their production as collateral for the loan, receiving a per-unit loan rate for the crop. But rather than repay the full loan (plus interest), farmers may repay the loan at a lower repayment rate at any time during the loan period that market prices are below the loan rate. Marketing loan repayment rates for wheat, feed grains, and soybeans are based on local, posted county prices (PCP), and repayment rates for rice and upland cotton are based on the prevailing world market price.³ When a farmer repays the loan at a lower posted county price or prevailing world market price, the marketing loan gain, or the difference between the loan rate and the loan repayment rate, represents a program benefit to producers. In addition, the program waives any accrued interest on the loan when the loan repayment rate is below the loan rate plus interest.

Alternatively, farmers of crops covered by the loan programs (except extra-long staple cotton) may choose to receive marketing loan benefits through direct loan deficiency payments (LDP). The LDP option allows the producer to receive marketing loan benefits without having to take out and subsequently repay a commodity loan. The LDP rate is the amount by which the loan rate exceeds the posted county price or prevailing world market price, and thus is equivalent to the marketing loan gain that farmers could obtain for crops

³ PCPs are calculated daily except weekends and holidays. Prevailing world market prices for rice and upland cotton are calculated weekly.

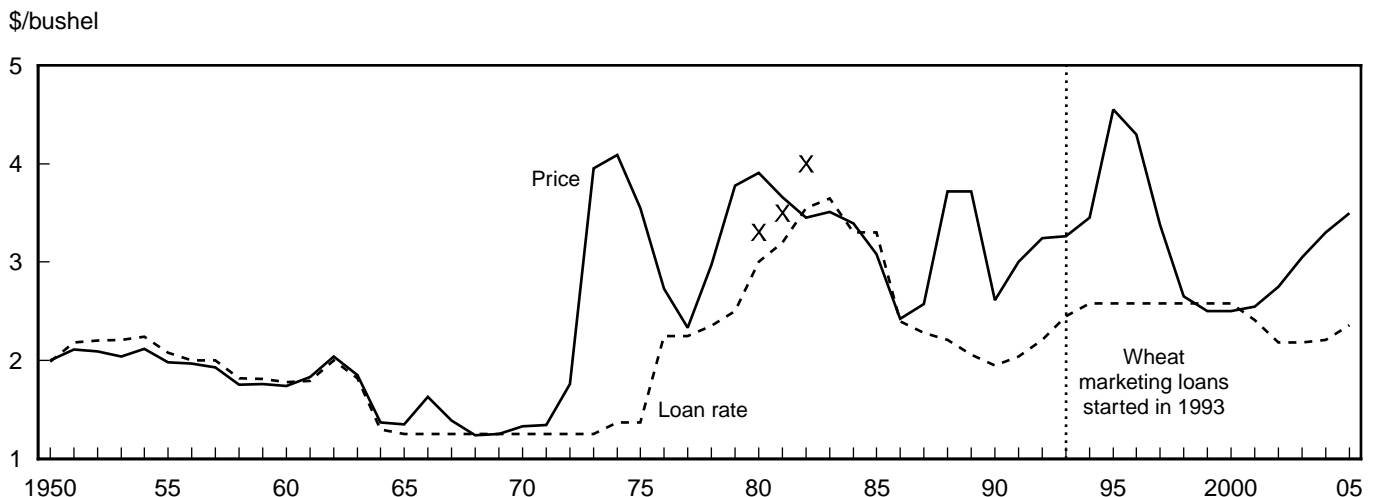
under loan. If an LDP is paid on a portion of the crop, that portion cannot subsequently go under loan.

Loan Program History

Figures 1-5 show historical loan rates and annual prices received by farmers for wheat, corn, soybeans, rice, and upland cotton since 1950, as well as USDA's February 2000 baseline projections for these variables (except cotton prices) through 2005. In some years, annual crop prices were above the corresponding loan rates, and farmers used the loan program mostly as a source of short-term liquidity until they sold their crops. In other years, crop prices were near loan rates, and loan program activity supported market prices through placements and forfeitures.

This price-supporting aspect of the loan program was particularly evident before 1970, in the early- to mid-1980's for corn and wheat, in the early 1980's for upland cotton, and in the mid-1980's for soybeans. Loan placements during these periods were generally high, representing a significant portion of production, and farmers forfeited a large amount of those placements to the government. For example, loan placements of the 1985 soybean crop reached nearly 25 percent of production, and farmers forfeited nearly 60 percent of those placements (about 14 percent of the crop) to the government (Schaub, McArthur, Hacklander, Glauber, Leath, and Doty). Season average prices for soybeans for 1985 (when 1985 loan placements occurred) and 1986 (when most 1985-crop

Figure 1
Wheat prices and loan rates, 1950-2005



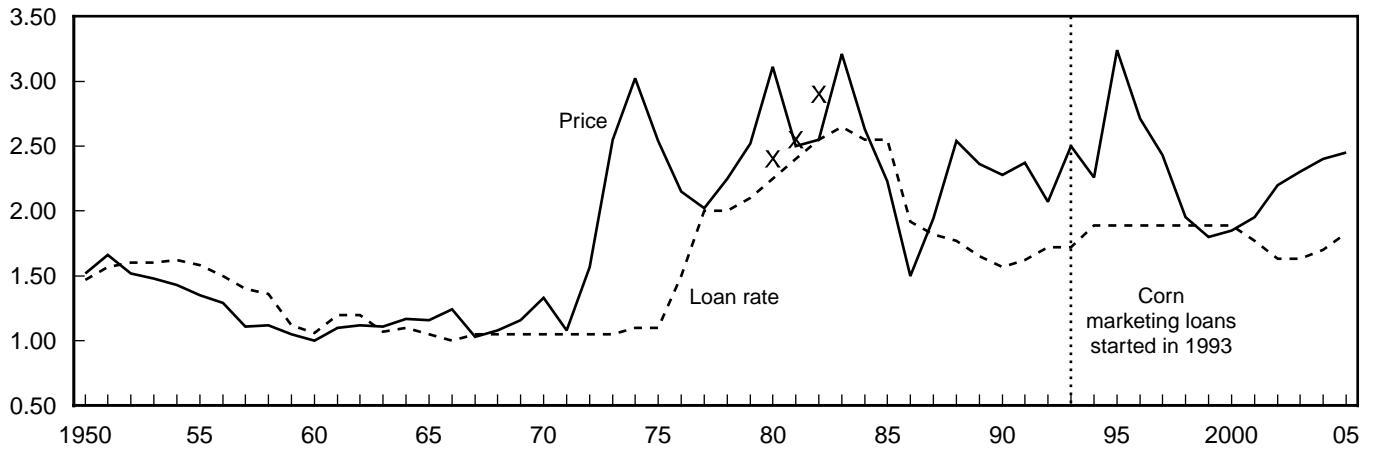
X = Higher FOR loan rate, 1980-82.

Source: 1999-2005, February 2000 USDA baseline projections.

Figure 2

Corn prices and loan rates, 1950-2005

\$/bushel



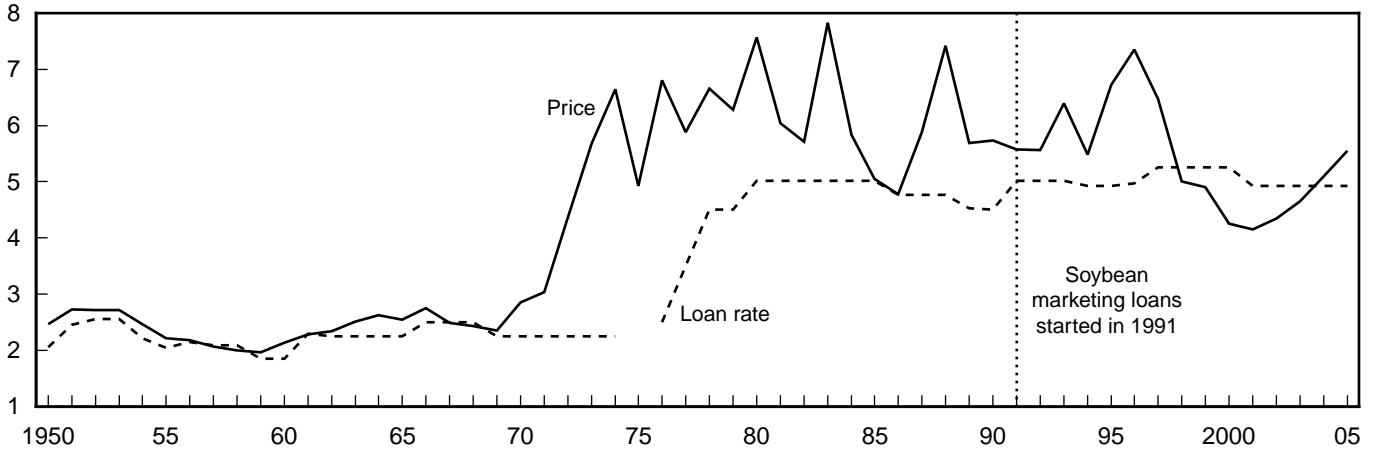
X = Higher FOR loan rate, 1980-82.

Source: 1999-2005, February 2000 USDA baseline projections.

Figure 3

Soybean prices and loan rates, 1950-2005

\$/bushel



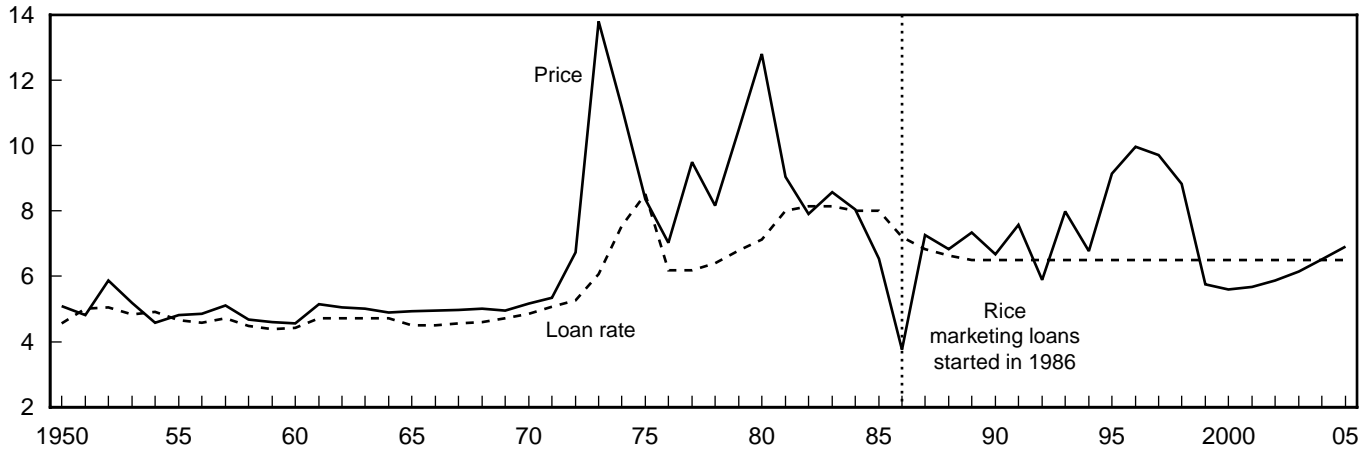
Note: There was no commodity loan program for the 1975 soybean crop.

Source: 1999-2005, February 2000 USDA baseline projections.

Figure 4

Rice prices and loan rates, 1950-2005

\$/cwt

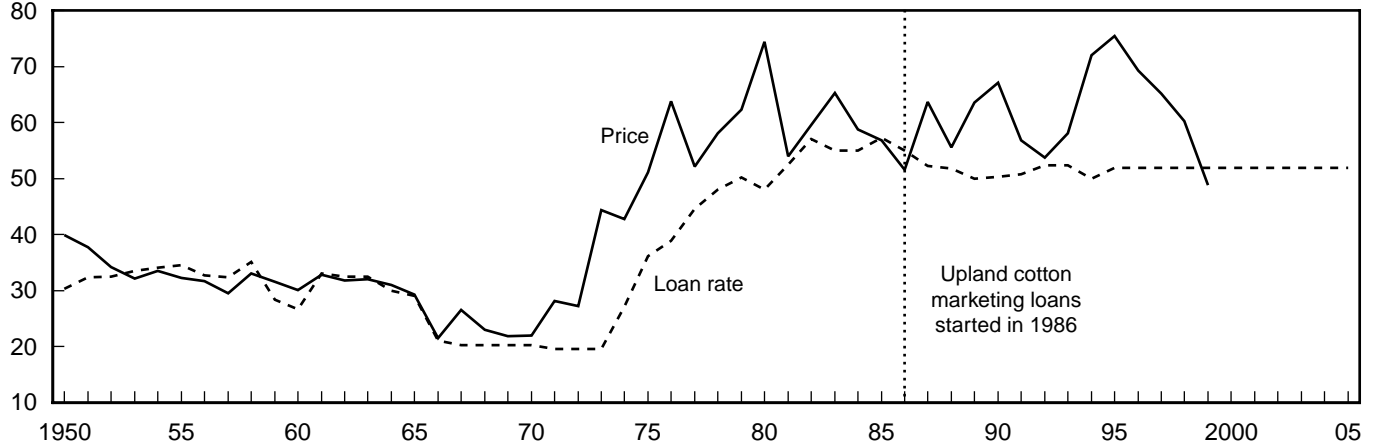


Source: 1999-2005, February 2000 USDA baseline projections.

Figure 5

Upland cotton prices and loan rates, 1950-2005

¢/pound



Note: USDA is prohibited from publishing cotton price projections. The 1999 price shown is the average of the first 2 months of the crop year, reflecting data available when the baseline analysis was conducted.

Source: 1999-2005, February 2000 USDA baseline projections for loan rates.

loan program forfeitures occurred) were within a few cents of the loan rates.

Support to corn and wheat prices in the early- to mid-1980's reflected the loan program augmented by the farmer-owned reserve (FOR). In 1982, for example, loan program forfeitures pushed government-owned stocks of corn to more than 1.1 billion bushels, or 16 percent of annual use, while government-owned stocks of wheat rose to almost 200 million bushels, representing 8 percent of annual use. Incentives provided for crops entered into the multiyear FOR (storage subsidies and, in some years, a higher loan rate) further encouraged loan placement activity for corn and wheat. By 1982, corn held in the FOR rose to almost 1.9 billion bushels, about 26 percent of annual use, and the wheat FOR exceeded 1 billion bushels, representing 44 percent of annual use. The long duration of grain storage under the FOR program, along with high release prices needed for grain to exit the reserve, effectively isolated a large amount of grain from the marketplace and combined with the high level of government-owned stocks to significantly affect corn and wheat prices (Westcott and Hoffman).

In recent years, strong U.S. and global production combined with some weakening of world demand due to the global financial crisis led to a decline in crop prices from the relatively high levels of the mid-1990's. Projected prices in USDA's 2000 baseline remain near or below loan rates for the next several years (USDA, OCE). The introduction of marketing loan provisions to the commodity loan programs, however, has changed the nature of this domestic support program from the

price-supporting role of earlier loan programs. While marketing loans still provide an economic incentive to producers, the program benefit is now provided through income transfer rather than price support achieved by government acquisition of the crop through loan program forfeitures. Under marketing loan provisions, producers generally retain ownership of the crop and sell it in the marketplace at market prices, without prices being supported by government purchases. Nonetheless, marketing loan benefits to producers mean that the economic incentive for production decisions is related to the loan rate rather than to the market price, thus introducing potential production-influencing effects into the marketplace.

The 1996 Farm Act limited marketing loan benefits (through marketing loan gains or loan deficiency payments) to \$75,000 per person per year. For payment limitation purposes, a three-entity rule allows farmers to have a full share in one farm entity and as much as a 50-percent share in two additional farm entities, thereby doubling the effective payment limitation for an individual producer. The payment limitation for marketing loan benefits was subsequently raised to \$150,000 for 1999 crops. Further, in early 2000, the availability of commodity certificates resumed. Producers with outstanding nonrecourse loans can purchase commodity certificates and then exchange them for the commodities under loan. Certificates are designed to limit loan program forfeitures of crops to the government. They also enable producers to receive marketing loan benefits unconstrained by payment limitations.