FARM PROGRAM SUPPORT MECHANISMS

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Abstract

The Farm Security and Rural Investment Act began with the 2002 crop and extends through the 2007 crop. For the program to be effective, it is necessary that producers understand how changing market conditions impact the support mechanisms that we have in place.

Introduction

It is a pleasure to address today's production conference and present an overview of the support mechanisms provided under the current farm bill. The current program plays a vital role in enhancing the health of the cotton production sector, particularly in times of depressed prices. However, for the program to be effective, it is necessary that producers understand how changing market conditions impact the support mechanisms that we have in place.

Features of 2002 Farm Bill

The Farm Security and Rural Investment Act, or more commonly known as the 2002 farm bill, began with the 2002 crop and extends through the 2007 crop. While the new legislation continues many of the same principles of the previous farm bill, such as decoupled payments, planting flexibility, and no acreage reduction programs, there are several new twists that producers are still adjusting to.

Base and Yield Updating

The farm bill provided a range of options for updating base acreage and/or program yields. It's difficult to overstate the importance of this decision since the base and yield selections determine the pounds of cotton that receive the direct and counter-cyclical payments. In many cases, producers were deciding between options that required tradeoffs between base acres for different crops. Fortunately, USDA provided decision tools to help aid producers evaluate the options. Just last month, USDA released data on the base and yield elections by state and crop.

Marketing Loans

The '02 farm bill retains the marketing loan program, operated in much the same fashion as under the '96 legislation. There were some modest adjustments and I'll touch on those next. The current bill makes direct payments that do not depend on price or production –again a feature that is very similar to the payments of the previous farm bill. But, perhaps the most notable change is the introduction of counter-cyclical payments, or CCP's as they're called.

For upland cotton, the base loan rate is fixed at 52 cents per pound, just slightly higher than the maximum rate of 51.92 cents allowed under the '96 bill. Also, the current farm program removed the Secretary's discretion to adjust the loan rate over some range. One other change worth noting is that the maximum length of the loan is reduced from 10 months to 9 months. Repayment of the loan remains the higher of the loan rate plus storage and interest or the adjusted world price.

Decoupled Payments

The direct payment for upland cotton is 6.67 cents per pound. Again, these payments do not depend on price or the current acreage decision. The payments, made in two installments for each crop, are paid on 85 percent of base acreage and the program yields established under the previous farm bill.

A new feature of the '02 farm bill, and one that continues to generate a lot of questions, is the counter-cyclical payment. Resurrecting terminology from past farm bills, we now have target prices for upland cotton, grains, and oilseeds. For cotton, the price is set at 72.4 cents per pound in each year of the farm bill. I add that last caveat because for grains, the target price for this year's crop is slightly different than the one in effect for '02 and '03. The target price is used to determine the CCP. If a CCP is to be made, then as with the direct payment, it's paid on 85 percent of the base. But, unlike the direct payment, the CCP is made on the new program yields, if the producer chose to update. If the producer did not update yields, then CCP's and direct payments are paid on the same yield.

The next question is "How are the CCPs actually determined?" We start with the target price. Next, subtract the direct payment. Then, subtract the higher of the loan rate or the market-year-average price. If the difference is above zero, then that amount is the counter-cyclical payment. As the chart shows, when the market-year-average price is below the loan rate, then the CCP is at its maximum level of 13.73 cents. As the MYA price moves above 52 cents, then the CCP falls, and goes to zero as the price reaches 65.73 cents.

The market-year-average price used to determine the CCP is published by USDA's NASS and represents the average price received by farmers for the marketing year. For cotton, the marketing year is August to July. The MYA price is an average of monthly prices, where the months are weighted by the amount of cotton sold in that particular month. In general, the months of October through February carry the largest weight.

While the MYA price reflects average prices across all producers and markets, it is useful to know how the price relates to price information that is readily available to all producers. One way to do that is to compare the monthly farm price to the average closing value of the nearby New York futures contract. While the wedge between the two varies, we generally see the two track together fairly well with an average difference of 7 cents per pound.

CCPs were established to provide greater support in times of low prices and less as prices increase. We have certainly seen that demonstrated over the first two years of the farm bill. With low prices for the '02 crop, the CCP was at the maximum level of 13.73 cents. For the current crop year, prices have increased substantially, and monthly prices through November would suggest a counter-cyclical payment of only 3.33 cents.

Timing of Payments

With the new farm bill came a new schedule of payments. Direct payments for each crop are made in two installments –one in December and the other in the following October. In the case of CCPs, those can occur in as many as three installments. The first installment, which can be as much as 35 percent of the projected CCP, is made in October of the year the crop is harvested. The second installment, if necessary, occurs the following February, with any remaining amount to be made in October once the full information for the MYA price is known.

The timing of direct payments during calendar 2004 will be as follows: the final installment for the '04 crop will be made in October, while the first half of the '05 payment is available in December. Counter-cyclical payments would occur in February and October. However, the amount of these payments, if any are made, will be dependent on USDA's projections of the MYA price, or in the case of the final installment, it depends on the final price information.

Summary

The current farm bill is vital to the structure and stability of the U.S. cotton production sector. I hope that I've been able to provide a brief overview of how the policies work, but in these few minutes, I certainly haven't given the thorough explanation that it deserves. In your program, you'll find the schedule for an afternoon workshop for today and tomorrow that will provide a much more in-depth explanation and the opportunity to answer any questions you may have.