A Primer on Farm Subsidies: How Income-Support Payments Work

Farmers can receive three types of income-support payments for the production and sale of wheat, corn, grain sorghum, barley, oats, cotton, rice, soybeans, or other oilseeds. These payments are:

Direct Payments, calculated based on 85 percent of the farmer's historical yield,[1] base acreage,[2] and payment rate.[3]

Counter-Cyclical Payments, calculated based on 85 percent of the farmer's historical yield, base acreage, and a payment per unit[4] that varies depending on market prices. The amount of the payment per unit is determined by the difference between a target price[5] previously determined and the actual market price.

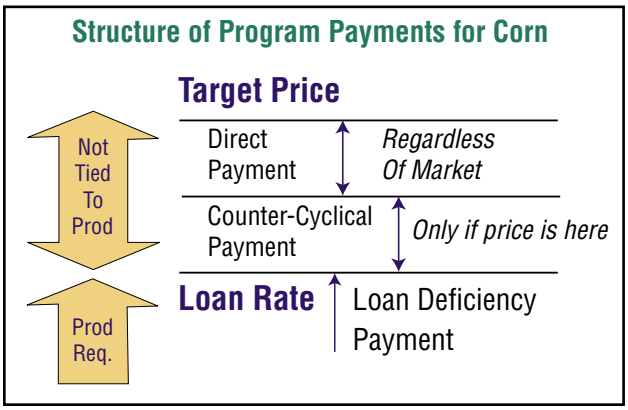
Loan Deficiency Payments, provided when market prices drop below a specified loan rate.[6] These payments are determined by the difference between the loan rate and the market price. Payments are made on 100 percent of production.

Terry Smith farms 100 acres in Dawes County, Nebraska.* Her historical base is 100 acres of corn and her historical yield is 136 bushels per acre. This year, she decides to plant 50 acres of corn and 40 acres of soybeans, leaving 10 acres fallow. Her land yields 143 bushels per acre of corn and 41 bushels per acre of soybeans.

Based on her base acreage and historical yield, Terry is eligible to receive a direct payment and a countercyclical payment. As legislated in the 2002 farm bill, the payment rate for corn is $.28 per bushel. Each year, Terry receives a direct payment of $3,237 [(.85 x 100 base acres) x (136 bushels per acre x $.28 per bushel)].

For the same year, the target price for the countercyclical payment is $2.63 per bushel. To determine the size of Terry's countercyclical payment, first it is necessary to get the "effective price" for corn, which is the direct payment rate plus either the national loan rate or the national season-average market price, whichever is higher.

If the season-average market price was $2.20 per bushel (higher than the national loan rate of $1.95), the effective price would be $2.48 ($.28 + $2.20). Therefore, the payment rate for countercyclical payments is $.15. Terry would therefore receive a coun-



Footnotes

[1] Historical yield refers to yields based on calculations for 1998-2001.

[2] Base acreage refers to the number of acres of a particular commodity in production.

[3] Payment rate is set in law and is defined in terms of $ per bushel/ton/pound/hundredweight.

[4] Unit is measured in terms of a bushel/ton/pound/hundredweight per acre.

[5] Target price is set in law and is defined in terms of $ per bushel/ton/pound/hundredweight.

[6] Loan rate is set in law and is defined in terms of $ per bushel/ton/pound/hundredweight.

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Commodity program payments to corn producers are estimated to average $5.4 billion per year and account for 46 percent of total crop payments from 2002-2006.

tercyclical payment of $1,734 [(.85 x 100 base acres) x (136 bushels per acre x $.15 per bushel)].

The third type of payment—loan deficiency—makes up the difference between the market price and the loan rate. Terry decides to exercise her option to collect a loan deficiency payment for both crops on January 20. That day's local price for corn (the Posted County Price) is $1.71 per bushel and the loan rate for Dawes County is $1.90. Terry's loan deficiency payment is $680 [50 acres planted x (143 bushels per acre x $.19 per bushel)]. Since the market price for soybeans on that day exceeds the local loan rate ($4.87 and $4.61, respectively), she receives a loan deficiency payment for soybeans. She keeps her crop and sells it when she chooses.

$3,237 – direct payment
$1,734 – countercyclical payment
$1,358 – loan deficiency payment

$6,329 – total payments

* The example illustrates how the three income support programs fit together for a producer (under policies in effect from fiscal years 2004 to 2007).

	Corn	Soybeans	Fallow
Base acres	100	-	-
Acres actually planted	50	40	10
Historical yield per acre	136 bu/acre	-	-
Actual yield per acre	143 bu/acre	41 bu/acre	-
National loan rate	$1.95	$5.00	-
Local loan rate (Dawes County, NE)	$1.90	$4.61	-
Posted County Price (PCP) on Jan. 20, 2006, when farmer chooses to collect LDP	$1.71	$4.87	-
LDP rate (local loan rate-PCP)	$ .19/bu.	$0	-
National season-average market price	$2.20/bu.		-
Effective price	$2.48/bu.		-
Direct payment rate	$ .28/bu.	$ .44/bu.	-
Direct payment	$3,237	-	-
Counter-cyclical payment	$1,734	-	-
Loan deficiency payment	$1,358	$0	-
Total government payment	$6,329		