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Understanding the Commodity Loan Programs for Major Row Crops in Georgia

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Commodity loan programs are a significant feature of U.S. farm policy and have been in existence in various forms since the 1930s. They have operated historically in two major ways: price support and income support. Started in 1933, commodity loan programs provided price support over most of their history. Producers who put commodities in the loan program with the Commodity Credit Corporation (CCC) would forfeit the commodity to the government if market prices at maturity were below the loan rate. The CCC held that commodity off the market, which acted to support market prices at the loan rate.

Beginning in the mid-1980s with the introduction of marketing loan provisions, commodity loan programs now provide income support instead of price support. Producers can now redeem loans at prices below the loan rate or receive loan deficiency payments and then sell the commodity in the open market. In this way, the loan rate no longer provides a market price floor (Hofstrand and Edwards, 2008).

The Agricultural Act of 2018 (2018 Farm Bill) extended the commodity loan programs for the 2019 through 2023 crop years with upward adjustments to the loan rates for selected crops. Commodity loan programs include the Marketing Assistance Loan (MAL) program and Loan Deficiency Payment (LDP) program. These programs provide farmers with alternative marketing tools during periods of low commodity prices. Producers can receive marketing loan benefits in the form of Marketing Loan Gains (MLG), Loan Deficiency Payments (LDP), Commodity Certificate Exchange Gains and Forfeiture Gains.

In the 2018 Farm Bill, the national average loan rates of most crops were increased, except for cotton, peanuts and some minor oilseeds. Table 1 shows the difference between loan rates in the 2014 Farm Bill and the 2018 Farm Bill, as well as the percentage increase in the loan rate for select commodities. This is the first-time loan rates have increased since the 2002 Farm Bill.

Based on each commodity's national average loan rate, county and regional loan rates may vary by location. County loan rates are adjusted by average market prices at a given location. For example, the national loan rate for corn in 2019 is $2.20 per bushel while the loan rate for corn in Miller County, Georgia is $2.43 per bushel (USDA, FSA, Commodity Loan Rates). Premiums or discounts may also be applied to the loan rate to reflect crop quality when a producer pledges the crop as collateral for a loan.

Table 1 Loan Rates in the 2014 and 2018 Farm Bills for Selected Covered Commodities

	Loan Rate		
Commodity	2014 Farm Bill	2018 Farm Bill	Percentage Increase
Corn (bu.)	$1.95	$2.20	13%
Grain Sorghum (bu.)	$1.95	$2.20	13%
Peanuts (tons)	$355	$355	0%
Soybeans (bu.)	$5.00	$6.20	24%
Upland Cotton (lb.)	2-year average of world prices (between $0.45 and $0.52/lb.)	2-year average of world prices, not less than 98% of previous year (between $0.45 and $0.52/lb.)	Varies
Wheat (bu.)	$2.94	$3.38	15%

Price Support

When commodity loan programs first started, producers had two options for closing out the loans: 1) repaying the loan principal plus accrued interest charges; or 2) settling the loan at loan maturity by forfeiting the loan collateral to the government and keeping the loan rate. The forfeit option is equivalent to selling the crop to the government at a price equal to the loan rate. When producers forfeited the loan, the government forgave the interest for the loan. During periods of low commodity prices, the likelihood of producers forfeiting the loan increased substantially. If prices were below the loan rate, the government then became the buyer of last resort for the commodity. When producers forfeited the loan, the government had to acquire the crop, which, in combination with CCC sales price restrictions, removed the crop from the marketplace. As a result, the early stages of the commodity loan program provided price support for those loan eligible commodities.

The low market prices in the 1950s, 1960s and 1980s led to frequent loan forfeitures and large government stocks. As a result, the commodity loan program at that time significantly impacted producers' planting decisions--producers grew crops based on the relative loan rates rather than market prices. To lower commodity procurement costs and reduce government stocks, additional program features were added to the 1985 Farm Act to reduce commodity forfeitures to the government as loan settlement.

Income Support

The 1985 Farm Act provisions introduced marketing loans for rice and upland cotton, and subsequent legislation mandated the availability of marketing loans for other commodities including soybeans and other oilseeds in 1991, wheat and feed grains in 1993 and other crops in 1996. Marketing loan provisions allow farmers to repay commodity loans at less than the original loan rate (plus interest) when market prices are lower.

The operation of the commodity loan programs changed significantly from price support to income support with the introduction of marketing loan provisions. It decreased the loan program's potential effect on supporting prices by reducing the government's purchase of the crop and accumulation of stocks through loan forfeitures. Instead, marketing loans now provide farmers economic incentives to retain ownership of crops and sell in the market place at market prices rather than forfeiting the crops to the government for loan settlement. Thus, the marketing loan provisions reduce the forfeiture of the crop as a repayment method, minimize the accumulation of government stocks and ensure the competitiveness of the crop in the global market.

In practice, many farmers tend to use a two-step marketing procedure when utilizing commodity loan programs. In the first step, the farmer decides when to take the marketing loan benefits. In the second step, the farmer decides when to sell the crop. Producers can participate in MALs or obtain Loan Deficiency Payments on all or part of their production anytime during the loan availability period, which runs from harvest until a specified date by crop in the following calendar year.

Marketing Assistance Loan (MAL)

Operated by the USDA, the Marketing Assistance Loan (MAL) program provides both a floor price and interim financing for loan eligible commodities. Since prices tend to be seasonally low at harvest, producers can put the harvested crop under a nine-month, non-recourse loan[1] valued at the loan rate for that commodity (Figure 1). Under the MAL program, the harvested crop is the loan collateral and the loan rate establishes a price floor for the commodity. The MAL program helps producers meet cash flow needs for the farm while delaying the sale of the crop until more favorable market conditions emerge.

The maturity date of the MAL is on the last day of the ninth month following the month in which the loan is made. The MAL can be redeemed either by the repayment of the loan or by delivering the pledged crop to the CCC as full payment for the MAL at maturity. Under certain circumstances, producers may repay loans at an alternative loan repayment rate less than the loan rate plus accrued interest and other charges. This occurs when market prices are below the loan rate. A producer may repay a loan at any time after the loan is made up until the loan's maturity date.

Producers participating in the MAL program are required to keep the crop as loan collateral in storage approved by the USDA CCC to preserve the quality of the crop.

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[1] Recourse marketing assistance loans are different from non-recourse marketing assistance loans. Recourse loans can only be redeemed by cash repayment, but non-recourse loans can be redeemed by cash repayment as well as by delivering the crop pledged as loan collateral for full payment of an outstanding loan to the Commodity Credit Corporation (CCC).

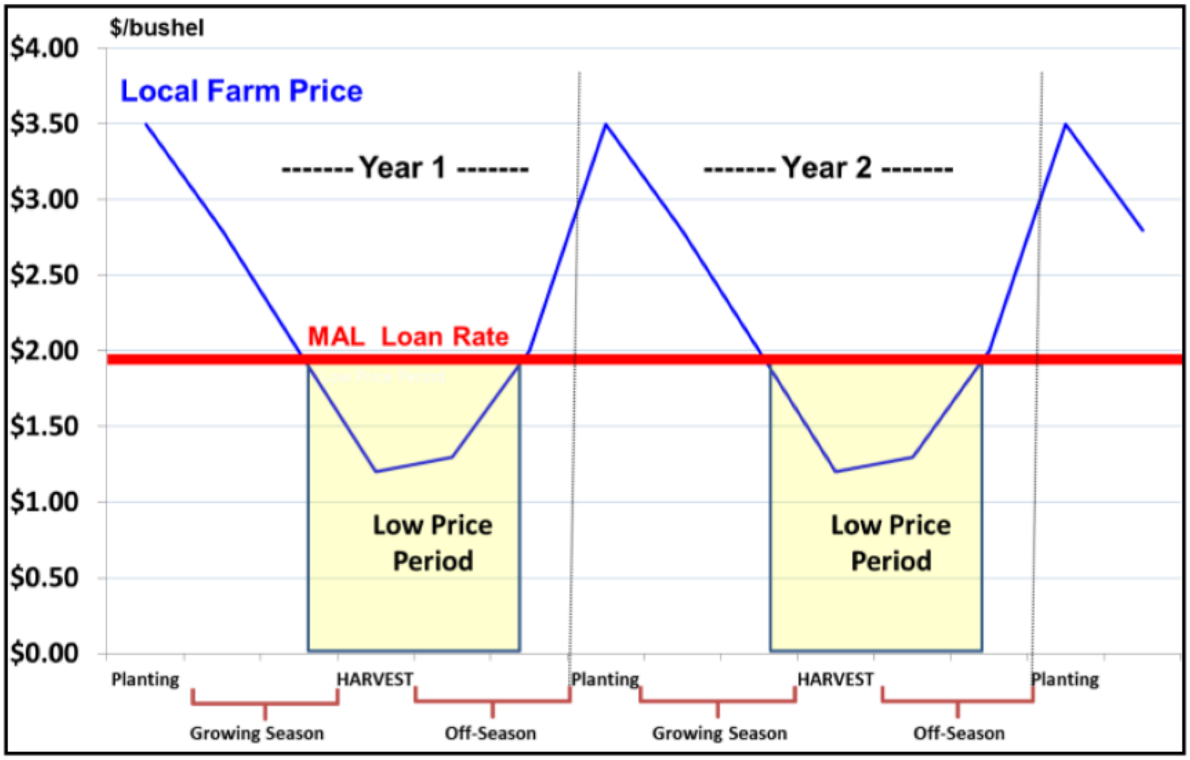

Figure 1 Traditional Crop Cycle and Price Pattern. Hypothetical example for two-year period. Source: Congressional Research Service Report No. IF11162.

Below are circumstances by which farmers can close out the loan:

- If the market price for the commodity is above the loan rate plus interest, the farmer would benefit from repaying the loan plus interest and reclaim the crop to sell at market price.
- If the market price is above the loan rate but below the loan rate plus interest, the farmer has economic incentives to use two choices: repayment of the loan at the alternative loan repayment rate or forfeiture of the crop.
- If the market price remains below the loan rate (Figure 2), the farmer has economic incentives to use one of four benefits: 1) repay the loan at an alternative loan repayment rate and receive benefits from the MLG[2], 2) forfeit the crop to the CCC and receive forfeiture gains, 3) purchase a Commodity Certificate Exchange (CCE) and receive commodity certificate exchange gains, or 4) take a loan deficiency payment (LDP) in lieu of a MAL. The value gains by producers are equivalent among all four potential benefits.

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[2]When a farmer repays the loan at PCP, NPP, or AWP, the farmer receives the program benefits in terms of the marketing loan gain (MLG), which is the difference between the loan rate and the alternative loan repayment rate. Any accrued interest and other charges on the loan are waived when the loan repayment rate is below the loan rate plus interest.

The alternative loan repayment rate is determined by the market price. Producers are encouraged to compare alternative loan repayment rates with the loan rate for loan eligible commodities. For wheat, feed grains and oilseeds, the CCC determines the local market price, which is often referred to as the posted county price (PCP). The PCP is a 30-day moving average of the estimated local market price. It is based on commodity prices at major terminal markets, with adjustments based on quality and location differentials (Hofstrand and Edwards). PCPs are announced daily for wheat, feed grains and soybeans, and weekly for other oilseeds. For peanuts, the CCC determines a national posted price (NPP) for the four types of peanuts and announces them weekly. For upland cotton and rice, the alternative repayment rate is the prevailing world market price converted to a U.S. location by adjusting for quality and transportation costs, referred to as the Adjusted World Price (AWP). The AWP is announced weekly.

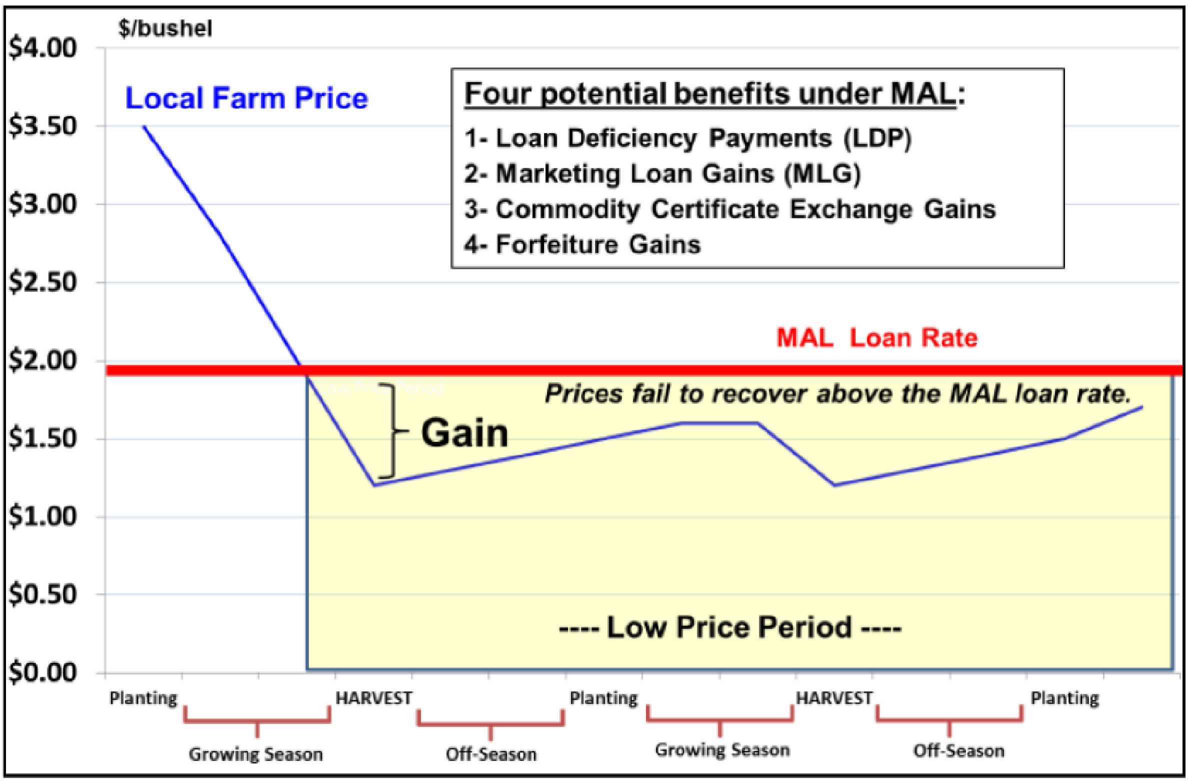

Figure 2. Four Types of Additional MAL Benefits. Example of extended period of low market prices. Source: Congressional Research Service Report No. IF11162.

Loan Deficiency Payment (LDP)

The LDP payment rate equals the difference between the loan rate and the alternative loan repayment rate (PCP, NPP or AWP). A Loan Deficiency Payment is made to the producer directly after they give up their non-recourse MAL when the alternative loan repayment price is below the loan rate. The total amount of the LDP equals the LDP rate times the eligible quantity of the crop.

LDPs can be issued for crops in certified storage on farm, for commodities verified by warehouse receipt, or production that will be sold directly from the field (with load summaries providing production evidence). Under the LDP program, the producer can store their crop in their preferred storage and have the freedom of when to sell their crop in the market. To be eligible for an LDP, the crop must not have been previously pledged as collateral for the MAL program and repaid at less than principal and interest. If an LDP is paid on a portion of the crop, that portion cannot subsequently go under the MAL program.

Commodity Certificate Exchange (CCE)

The 2016 Consolidated Appropriations Act resumed the Commodity Certificate Exchange (CCE). Agricultural producers with a commodity pledged as collateral for a MAL can purchase a commodity certificate. These certificates can then be exchanged for their outstanding loan collateral, and thus pay off the loan. This in lieu of forfeiting loan collateral (the commodity under loan) to the CCC, thereby minimizing storage and delivery costs and limiting forfeitures of crops to the government at loan maturity. According to USDA, commodity certificates are available only in situations where the MAL rate exceeds the exchange rate.

The CCE rate is the same as the alternative loan repayment rate, which is the AWP for upland cotton or rice, the NPP for peanuts or the PCP for other commodities. Realized gains from the certificate exchange, also called certificate exchange gains, equal the amount by which the loan rate exceeds the CCE rate.

Eligibility and Payment Limits

Producers must meet eligibility requirements to participate in the commodity loan program such as active engagement in farming and conservation compliance provisions. Under the 2018 farm bill, the marketing loan benefits are no longer subject to annual payment limits, which include MLGs and LDPs. Producers or legal entities whose adjusted gross income exceeds $900,000 are not eligible for MALs and LDPs, but can utilize the commodity certificate exchange for the MAL and realize any certificate exchange gains using the commodity certificate exchange. Finally, a farmer must own the beneficial interest of a crop when the marketing loan benefit is taken, that is, the farmer may not receive the marketing loan benefits after the crop is sold.

This fact sheet is for educational purposes only. For specific information on covered commodities and prices, contact your local Farm Service Agency office. Information on local FSA office locations is available at https://offices.sc.egov.usda.gov/locator/app.

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Acknowledgments

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