

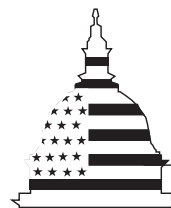
GAO

Report to the Ranking Minority Member,  
Subcommittee on Forestry,  
Conservation, and Rural Revitalization,  
Committee on Agriculture, Nutrition,  
and Forestry, U.S. Senate

November 1999

U.S. DEPARTMENT  
OF AGRICULTURE

Marketing Assistance  
Loan Program Should  
Better Reflect Market  
Conditions



G A O

Accountability \* Integrity \* Reliability

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**Resources, Community, and  
Economic Development Division**

B-283795

November 23, 1999

The Honorable Kent Conrad  
Ranking Minority Member  
Subcommittee on Forestry, Conservation,  
and Rural Revitalization  
Committee on Agriculture, Nutrition, and Forestry  
United States Senate

Dear Senator Conrad:

The marketing assistance loan program is designed to provide producers of certain crops with interim financial assistance at harvest, when prices are usually lower than at other times of the year. By doing so, the program effectively guarantees a minimum price for those crops. For 1998 crops, the program provided \$6.7 billion in loans. It also provided \$3.7 billion in cash payments, as of September 22, 1999, up from \$162 million for 1997 crops. This jump in cash payments occurred because of substantial declines in crop prices; payments are expected to grow to about \$5.9 billion for 1999 crops.

The program is composed of two major components—loans and loan deficiency payments—and is available to producers of certain crops—wheat, feed grains, oilseeds, upland cotton, and rice. Under the loan component, producers can obtain a marketing loan after harvest by using their crop as collateral. The loan amount is based on a statutory national loan rate (a per-unit price for each crop) that is adjusted by the U.S. Department of Agriculture (USDA) to reflect county variations in market prices across the country. To determine the loan amount, USDA multiplies the county loan rate by the amount of crop offered as collateral. Producers can settle a loan in one of three ways. First, producers can sell their crop and repay the loan plus interest. Second, if crop prices remain too low to allow producers to repay the loan plus interest, they can sell the crop and repay the loan at the posted county price—a USDA estimate of the local market price (for cotton and rice, USDA uses the adjusted world price)—and keep the difference. This difference is called a marketing loan gain and is one of two types of cash payments available through the program. Finally, producers can forfeit their collateral and keep the loan amount. The program's other component—the loan deficiency payment—provides the other type of cash payment available under the program. This payment reflects the difference by which the applicable county loan rate exceeds the posted county price on the day a producer

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requests a loan deficiency payment. If producers choose this component, they receive a cash payment and can sell their crop whenever they choose. The program did not allow producers to receive more than \$75,000 annually in cash payments—total marketing loan gains and loan deficiency payments. However, USDA's appropriations act for fiscal year 2000 (P.L. 106-78, Oct. 22, 1999) includes provisions that increased this payment limitation to \$150,000 for 1999 crops only.

The large increase in cash payments in 1998 prompted your concern, and you asked us to determine (1) which producers received cash payments through the program, by type of crop and state; (2) why some producers did not participate in the program; and (3) what types of concerns have been raised about the program's effect on cash payments and potential forfeitures.

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## Results in Brief

As of September 1999, \$3.4 billion of the \$3.7 billion in cash payments went to producers of four crops—corn, soybeans, wheat, and upland cotton. The top 10 states in which producers received this assistance were Illinois, Indiana, Iowa, Kansas, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, and Texas.

For a number of reasons, some producers of eligible crops did not participate in the marketing assistance loan program in 1998. These producers could not receive a loan deficiency payment because (1) the posted county price for their crop equaled or was higher than the applicable loan rate; (2) they had sold their crop before requesting a loan deficiency payment and therefore were no longer eligible for a payment; or (3) they had produced crops, such as rye, that were not covered by the program.

As the use of the marketing assistance loan program increased, producers and USDA officials raised a number of concerns about (1) inconsistencies in the cash payments available to some producers but not to others and (2) the heightened potential for loan forfeitures. First, they pointed out that because the rates for loan deficiency payments have been consistently higher in some counties than in nearby or adjoining counties, the program's design has created an incentive for producers to move their grain from one county to another to receive a higher payment. Many have done so. Second, because of the way USDA established its loan rates and posted county prices, producers of classes of wheat that have higher market prices have received, or are likely to receive, lower rates for loan

deficiency payments than producers of classes of wheat that have lower market prices. On the other hand, producers of lower-priced classes of wheat have been able to receive higher rates for loan deficiency payments. Third, because the national loan rates for some crops, such as soybeans, were set at levels that cover significantly more of production costs than the national loan rates for other crops, an incentive has been created to plant crops in response to government payments rather than to market demand—which was not the intention of the 1996 Farm Bill’s overall goals. Finally, the program had a cash payment limitation of \$75,000. USDA officials told us they were concerned that producers would use the program’s loan component to obtain financing and would forfeit their collateral to the government once they reach the payment limitation.<sup>1</sup> USDA has recognized that some inconsistencies and unintended consequences have emerged as the program has been implemented. However, the Secretary of Agriculture has not yet made the changes he could make to the program because of concerns about decreases in some producers’ income during a period of low crop prices. Other possible changes to the program’s design would require legislation. We are recommending that the Secretary develop and implement administrative changes and, as necessary, seek legislative changes from the Congress to address the issues we identified.

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## Background

The Federal Agriculture Improvement and Reform Act of 1996, referred to as the 1996 Farm Bill, changed the federal government’s long-standing approach to farm support—from a policy based on managing crop production and supporting farm income through a variety of payment mechanisms and supply restrictions to a policy that allows producers flexibility in what they plant and provides fixed, but declining, income support payments through fiscal year 2002. The 1996 Farm Bill retained a commodity loan program, including its provisions for marketing loan gains and loan deficiency payments. This program is now known as the marketing assistance loan program.

In 1996, the first year in which the 1996 Farm Bill was in effect, the marketing assistance loan program served primarily as a source of interim financing because crop prices were high enough to enable producers to sell their crops and repay their loans. However, in 1998, when market prices fell below the loan rates, a large number of producers turned to the marketing assistance loan program as a source of income.

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<sup>1</sup>As discussed earlier, USDA’s appropriation act for fiscal year 2000 provides an interim solution by increasing the payment limitation to \$150,000 for 1999 crops only.

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## How the Marketing Assistance Loan Program Works

To participate in the marketing assistance loan program, producers must meet several criteria. They must harvest eligible crops,<sup>2</sup> and for some crops, must have entered into the 7-year production flexibility contracts established in the 1996 Farm Bill.<sup>3</sup> Furthermore, producers must own the crop at the time they request assistance. That is, they must not have relinquished ownership of the crop by a date that is earlier than the date they requested assistance. This provision is necessary because, in order to provide a loan, the government must have the crop as collateral in case the producer does not repay the loan. The producer's retention of ownership is known as having a "beneficial interest."

## The Loan Program

To obtain a marketing assistance loan, a producer pledges the harvested crop as collateral and receives a loan based on the amount of the crop offered as collateral multiplied by a loan rate for each unit of eligible production. These loans provide producers with (1) financial assistance so they do not have to sell their crop at harvest, when prices at local grain elevators are usually lower than at other times of the year, and (2) a guaranteed price—up to the loan rate, for their production.

Producers can settle their loans in one of three ways. First, they can repay the loan's principal and interest within the loan period, usually 9 months, which is what producers generally do if crop prices are relatively high. Second, producers can forfeit the crop to the government when the loan matures and keep the loan principal as payment. This option provides producers with a minimum guaranteed price for their crops. Finally, producers of wheat, feed grain, and oilseeds can repay the loan at the posted county price—a USDA estimate of the local market price—prior to the loan's maturity date, and sell the crop on the market.<sup>4</sup> With this choice, the difference between the county loan rate and the posted county price—known as a marketing loan gain—is waived and is considered a cash payment to the producer. Accrued interest is also waived but is not considered a cash payment. The Secretary of Agriculture developed these

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<sup>2</sup>Barley; corn; upland cotton; grain sorghum; minor oilseeds (canola, crambe, flaxseed, mustard seed, oil-type sunflower seeds, other types of sunflower seed, rapeseed, and safflower seed); oats; rice; soybeans; and wheat.

<sup>3</sup>Under the 1996 Farm Bill, any producer whose farm had a recorded planting history for wheat, feed grains, upland cotton, and rice in any single year from 1991 to 1995 could sign a contract that provided annual payments through 2002, regardless of the crop planted.

<sup>4</sup>The 1985 Farm Bill mandated that cotton and rice producers be allowed to repay their loans at the lesser of principal and interest or the adjusted world price. The 1990 Farm Bill mandated that soybean producers be allowed to repay their loans at the lesser of principal and interest or a price that the Secretary of Agriculture determined to be the posted county price. Under the mandates of the Omnibus Budget Reconciliation Act of 1990, wheat and feed grain producers, beginning in 1993, were allowed to repay their loans at the lesser of principal and interest or the posted county price.

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procedures for marketing loan gains in response to a congressional mandate to establish alternative rates for loan repayments to minimize potential loan forfeitures.

### The Loan Deficiency Payment

In order to reduce the administrative work associated with producers' obtaining a loan and paying it back on the same day to obtain the marketing loan gain, statutory provisions mandated that USDA implement loan deficiency payments in 1985 for upland cotton and rice; in 1991, for oilseeds; and in 1993, for wheat and feed grains. The rate for a loan deficiency payment is the amount by which the applicable county loan rate exceeds the posted county price on the day the request for payment is made.<sup>5</sup> The rate provides an amount equal to the rate available for a marketing loan gain on the same day. When the posted county price is at or above the loan rate, no loan deficiency payments are available because the intent of the program is only to guarantee that producers will receive the loan rate for their crop. While producers who take a loan deficiency payment do not incur the interest and administrative fees associated with the loan option, they must assume the financial risk of decreases in crop prices.

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### Determining Loan Rates

The Secretary of Agriculture adjusts loan rates from a legislatively set national loan rate for each crop, generally on a county-by-county basis. The average of the county loan rates weighted for production for each crop must not exceed the national loan rate. The legislatively set national loan rates are no higher than 85 percent of the average market price for each crop for the preceding 5 years, excluding the high and low years.<sup>6</sup> In addition, the national loan rates for wheat and corn can be no higher than 1995 levels, and the national loan rate for soybeans may not exceed \$5.26 per bushel. USDA has not updated many of the county loan rates for wheat and feed grains in several years. Loan rates vary by location because they are based on market prices—which are influenced by factors such as local supply and demand and transportation. For example, in Iowa, the county loan rates for corn ranged from \$1.72 to \$1.91 per bushel, depending on the county where the loan was obtained. In contrast, in California, the county loan rates for corn ranged from \$2.37 to \$2.61 per bushel. Figure 1

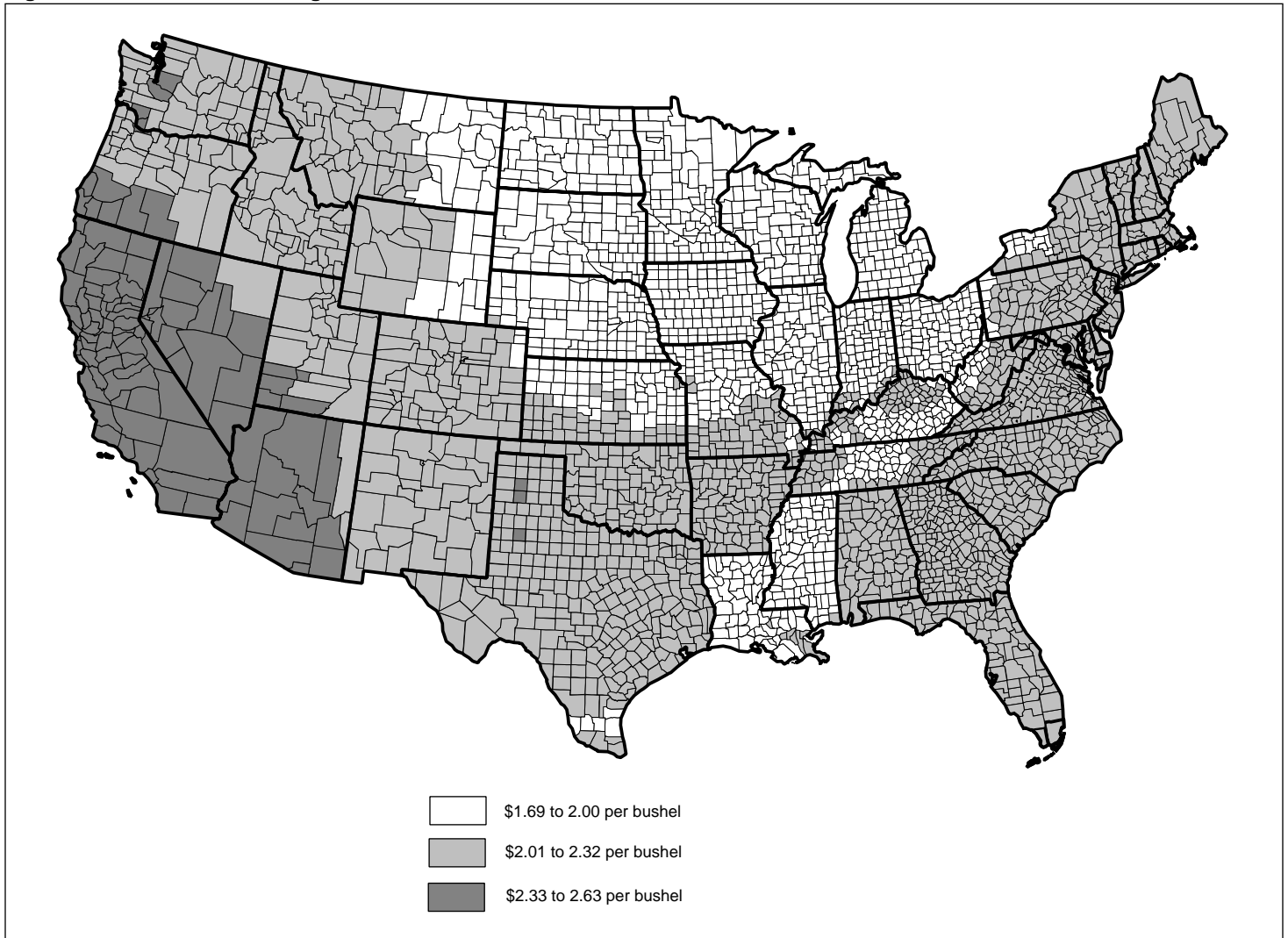
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<sup>5</sup>Cotton and rice use adjusted world prices. However because most of this report focuses on wheat, feed grains, and oilseeds, we use posted county prices throughout the report.

<sup>6</sup>For wheat, a weighted average posted county price for all classes of wheat is calculated on the basis of the percentage distribution of the acreage of wheat class produced. The upland cotton and rice loan rate formula differ somewhat.

shows the variation in the ranges of loan rates for corn throughout the United States in 1998.

Figure 1: Variations in the Ranges of Loan Rates for Corn Nationwide, 1998



Source: GAO's analysis of USDA's data.

### The Posted County Price System

USDA provides daily and weekly posted county prices in about 3,000 counties for 18 of the crops included in the marketing assistance loan



program. USDA establishes the posted county price for each county using current prices from several of 19 terminal markets (such as Kansas City, Missouri), adjusted for local supply and demand factors and transportation from the county to the terminal. These terminal markets are used to establish the posted county price, even though the grain may not actually be shipped to or marketed through the assigned terminal location. The Department makes adjustments, as needed, to ensure that posted county prices continue to reflect a value as close as possible to the local cash market price in any given area. Posted county prices are based on terminal prices from the previous marketing day or week.

## Cash Payments Provided to Producers

For 1998 crops, most of the \$3.7 billion in cash payments—\$3.4 billion—went to producers of four crops: corn, soybeans, wheat, and upland cotton. Producers of barley and oats, however, received payments that amounted to a higher percentage of the value of these crops. The top 10 states in which producers received loan deficiency payments were Illinois, Indiana, Iowa, Kansas, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, and Texas. Table 1 shows cash payments, by crop, for 1998.

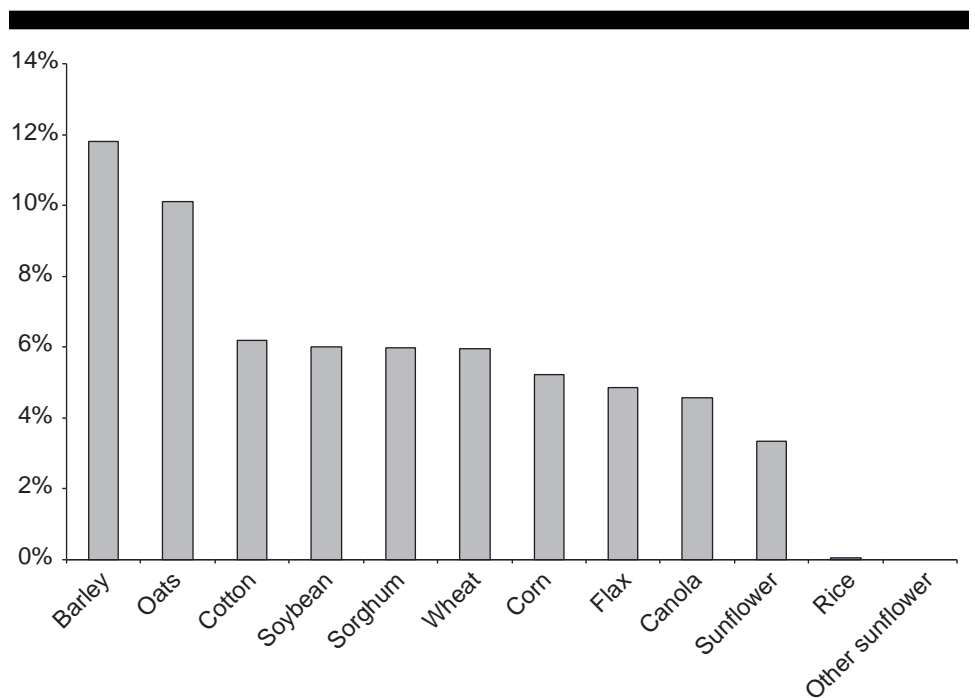
**Table 1: Cash Payments Provided by the Marketing Assistance Loan Program, 1998 Crops**

Dollars in thousands			
Crop	Marketing loan gain	Loan deficiency payment	Total cash payment
Corn	\$321,206	\$998,607	\$1,319,812
Soybean	316,399	880,796	1,197,194
Wheat (all classes)	56,572	413,487	470,060
Upland cotton	223,054	254,346	477,400
Barley	3,824	78,429	82,253
Sorghum	3,340	57,017	60,357
Oats	459	19,032	19,491
Sunflower oil	5,178	14,051	19,229
Canola	607	7,474	8,081
Flax	79	1,657	1,736
Rice	11,375	1,007	12,382
Sunflower	25	1	26
Mustard seed			0
Safflower			0
Rapeseed			0
<b>Total</b>	<b>\$942,118</b>	<b>\$2,725,904</b>	<b>\$3,668,021</b>

Source: GAO's analysis of USDA's data, as of Sept. 22, 1999.

Figure 2 shows the percentage of cash payments in relation to the value of the crop produced. A crop's market value is calculated by multiplying the annual average market price by the quantity produced. This figure shows that barley and oat producers received significantly larger payments in relationship to the value of these crops than did producers of other crops.

Figure 2: Cash Payments as a Percentage of the Value of the Crops Produced in 1998



Source: GAO's analysis of USDA's data.

Producers in 10 of the major crop-producing states received \$1.8 billion, or 66 percent of the loan deficiency payments for crops harvested in 1998. The top 10 states in which producers received this assistance were Illinois, Indiana, Iowa, Kansas, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, and Texas.

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## Reasons Some Farmers Did Not Participate in the Program

Some producers did not participate in the marketing assistance loan program in 1998 for a number of reasons. The issue of nonparticipation surfaced in 1998 because this was the first time that crop prices were low enough to cause large numbers of wheat, feed grain, and oilseed producers to seek income from the program. USDA gave several reasons why producers did not participate: (1) producers of eligible crops could not receive a loan deficiency payment when the posted county price for the crop equaled or was higher than the loan rate, (2) some producers had sold their eligible crop before requesting financial assistance, and (3) producers of other crops not specified by law as eligible, such as rye, could not receive assistance.

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## Loan Deficiency Payments Were Not Always Available

Because the rate for loan deficiency payments is based on the amount by which the applicable county loan rate exceeds the posted county price, payments are not available when the posted county price is at or above the loan rate. Therefore, producers who sought a loan deficiency payment for their harvested crop during a period when this condition was occurring could not obtain a payment. For example, according to USDA officials, no loan deficiency payments were available to producers of hard red winter wheat in Texas between June and July 1998. Similarly, for producers of durum wheat in North Dakota, loan deficiency payments were rarely available because the posted county price was seldom below the loan rate during 1998.

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## Producers Who Had Sold Their Crop Before Requesting Assistance Could Not Participate

Producers who had sold their crop could not participate in the program because of its beneficial interest rules. After producers sell their crop, they no longer have a beneficial interest. Some producers had not understood the implications of this provision in 1998 when they applied for assistance under the program. As producers become more familiar with the program's beneficial interest provision, however, they are likely to find it less of an obstacle to participation, according to USDA officials.

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## Program Assistance Was Limited to Producers of Eligible Crops

Producers of crops other than those specified in the program are obviously not eligible for benefits. However, one of these crops, rye, was covered by a commodity loan program before the 1996 Farm Bill. The 1996 Farm Bill did not include rye as an eligible crop.

USDA has extended coverage to crops for 1999 that it had not allowed in 1998—hull-less oats and crambe, an industrial oilseed. According to USDA

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officials, hull-less oats were not eligible in 1998 because the crop was not approved as a class of oats under the U.S. Official Grain Standards Act. However, according to an agricultural extension service official at North Dakota State University, hull-less oats are similar to traditional oats, which are included in the program. USDA decided that because the approval process is under way, the 1999 crops would be eligible. In 1998, crambe was not eligible, but the Secretary of Agriculture, under his discretionary authority for oilseeds, made it eligible for 1999.

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## Sudden Increase in Program Payments Surfaced Issues Related to Program Design

The sudden increase in program payments starting in 1998 surfaced a number of concerns among farmers and program officials about inconsistencies in the cash payments available to some producers but not to others and about the increased potential for loan forfeitures. First, because of the process used to determine the rates for loan deficiency payments—in particular, the relationship between the variables used to determine posted county prices and county loan rates—the rates for loan deficiency payments were consistently higher in some counties than in nearby or adjoining counties. As a result, some producers moved their grain to a county with higher rates. In addition, for the most part, USDA has not adjusted county loan rates for wheat and feed grains in a number of years. Second, USDA has one loan rate for wheat but five separate posted county prices—one for each class of wheat. The single loan rate for wheat is a weighted average of the prices and acreage produced for the five classes of wheat.<sup>7</sup> However, some classes of wheat, such as durum in 1998, have higher market prices and less production. As a result of the single wheat loan rate and the five posted county prices, producers of classes of wheat that have lower prices (such as soft white wheat in 1998) were able to obtain a higher rate for loan deficiency payments than producers of classes of wheat that have higher prices. Third, national loan rates for some crops, such as soybeans, cover a significantly higher percentage of the production costs than national loan rates for other crops. As a result, producers have chosen to plant some crops over others in response to government payments rather than to market signals. For example, the 1998 national loan rate for soybeans covered about 250 percent of the variable costs of production while the loan rate for corn covered about 150 percent of these costs. Finally, a \$75,000 payment limitation was in place for cash payments. USDA officials told us that because of the \$75,000 payment limitation, they were concerned that more producers would use the loan option in 1999 to obtain financing and forfeit their collateral to the

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<sup>7</sup>The five classes of wheat include Durum, Hard Red Spring, Hard Red Winter, Soft Red Winter, and Soft White.

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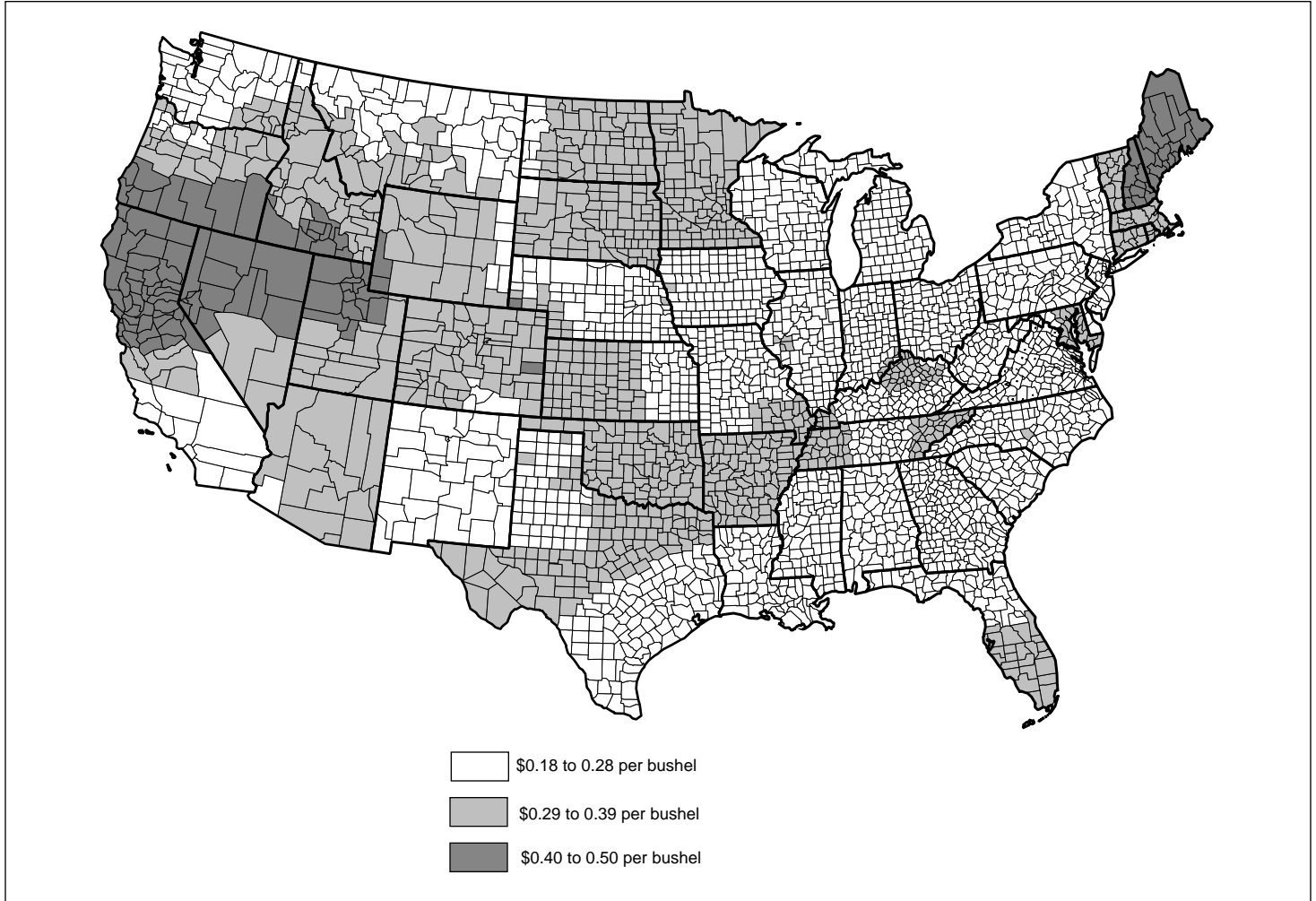
government once they reached the payment limitation. Any program-related gains for producers that are associated with forfeiture are not subject to the payment limitation. In this regard, USDA's appropriations act for fiscal year 2000 increased the payment limitation to \$150,000 for 1999 crops .

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**Producers Sought Higher Payments Across County Lines**

Rates for loan deficiency payments differ significantly across the nation for producers of the same crop on a given day. That is, the loan deficiency payment rate, which is the amount the county loan rate exceeds the posted county price, may be \$0.18 per bushel for a crop in one county and \$0.29 per bushel for that same crop in an adjoining county. According to USDA officials, producers, and grain elevator operators we spoke with, when the rate for a loan deficiency payment in a nearby county was higher, producers moved their crop to that county, ignoring their closer markets and storage facilities. Figure 3 illustrates the differences in rates for loan deficiency payments by county for corn on September 28, 1998.

Figure 3: Nationwide Rates for Loan Deficiency Payments for Corn, September 28, 1998



Source: GAO's analysis of USDA's data.

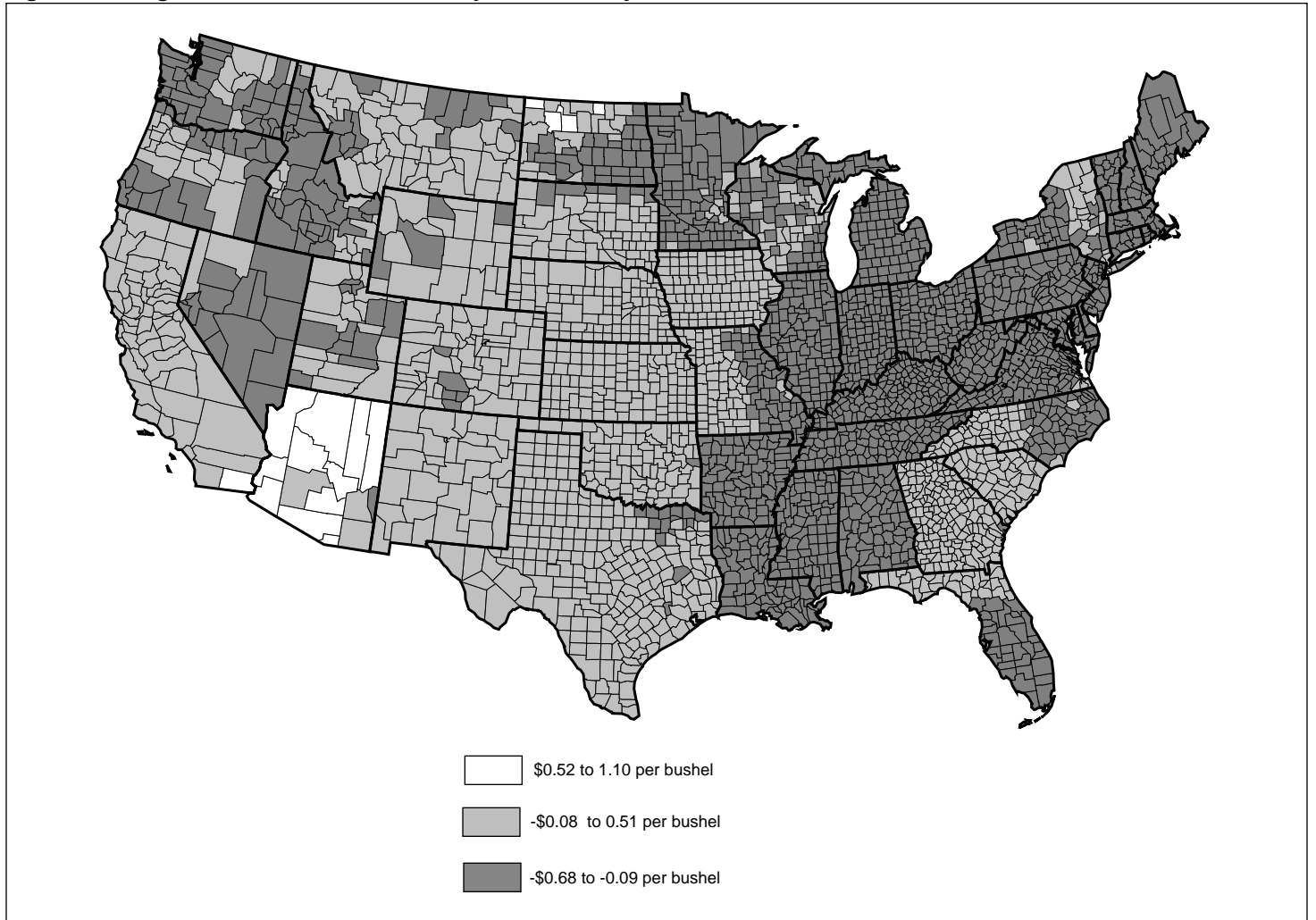
According to USDA, many of the differences in rates for loan deficiency payments have developed because USDA uses posted county prices (which change daily or weekly) and county loan rates (which are subject to change annually) in determining these rates. The differences in these rates are amplified because USDA has not adjusted most county loan rates for wheat and feed grains to reflect more recent relationships in market prices.

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In addition, according to USDA officials, posted county prices follow the market by a day or a week, depending on the crop. For 1998, we found that cash prices in the local market were higher than posted county prices by a per-bushel average of \$0.04 for wheat, \$0.04 for corn, and \$0.03 for soybeans. However, posted county prices were significantly different from local market conditions on occasion because USDA uses prices from different terminal markets to determine posted county prices. In these situations, these differences created incentives for producers to move their crop to areas receiving higher rates for loan deficiency payments. For example, in September 1998, the rate for a loan deficiency payment was higher for corn in Minnesota than in nearby counties in Iowa. A producer who transported corn to Minnesota would have received \$.08 more per bushel for corn. These particular variances occurred because USDA used different terminal market prices for corn-producing counties in Minnesota than it used for corn-producing counties in Iowa to determine posted county prices.

Although the Secretary of Agriculture has the authority to adjust county loan rates, USDA has generally not done so since 1995 because the demand for loans prior to 1998 was low and because, more recently, it did not want to lower loan rates during the current period of low crop prices. For example, if USDA had adjusted all the county loan rates for wheat for 1999 on the basis of current market prices and production patterns—within the national limits set by the Congress—the wheat loan rates would have decreased in 1,979 of the 2,857 wheat-producing counties. Figures 4 and 5 show the changes that would have occurred if the wheat and corn loan rates had been revised.

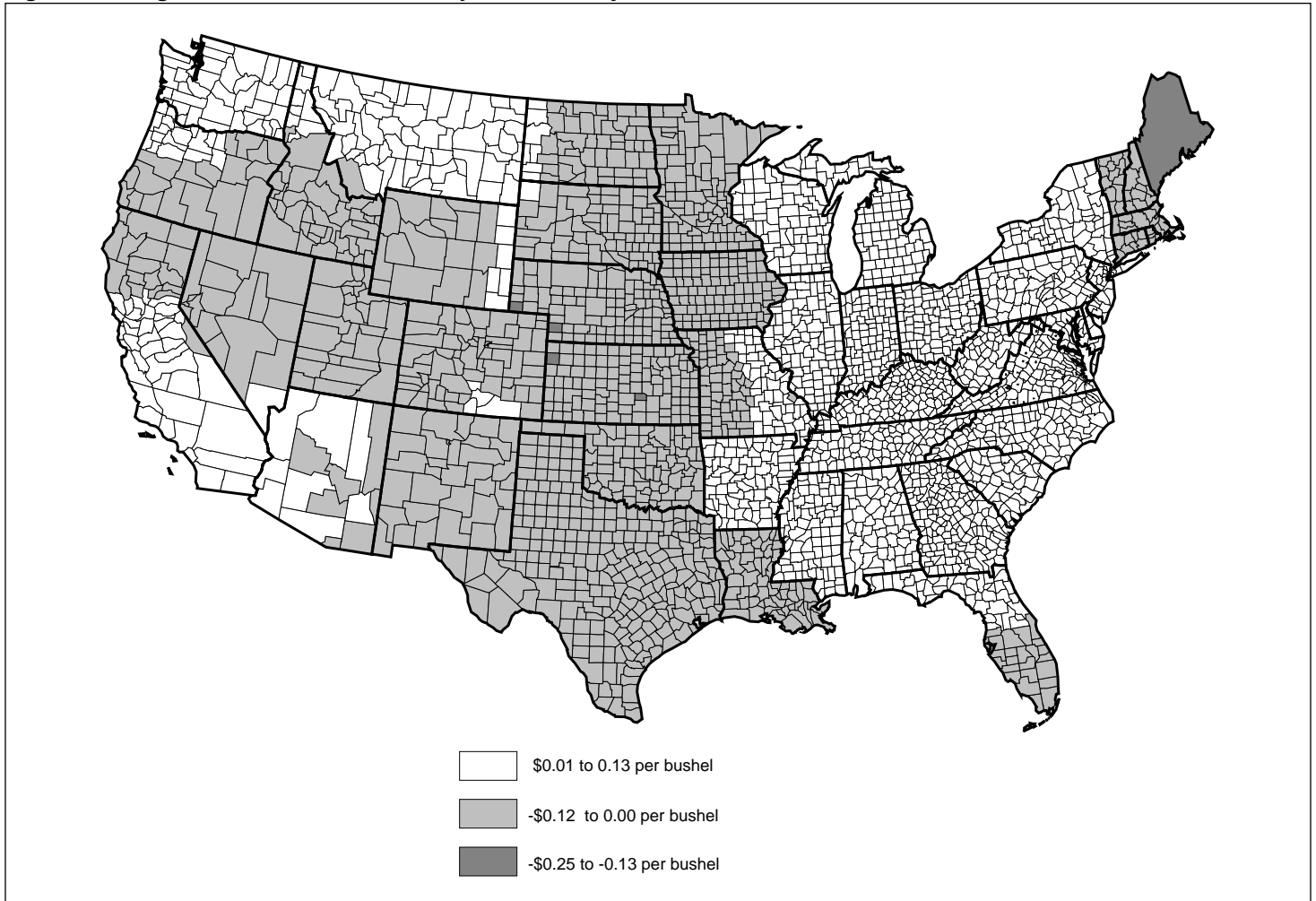
Figure 4: Changes in Wheat Loan Rates If They Had Been Adjusted



Source: GAO's analysis of USDA's data.



Figure 5: Changes in Corn Loan Rates If They Had Been Adjusted



Source: GAO's analysis of USDA's data.

In response to the problem of producers' choosing to market their crops in counties where the rates for loan deficiency payment are higher, USDA discussed the possibility of an alternative approach. Under this approach, the Secretary, acting within his authority, would establish a uniform rate for loan deficiency payments for each crop on a given day. However, USDA has not formally proposed this change. There are concerns that some

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producers would have lower loan deficiency payments and that government costs could increase.

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### Producers of Wheat Classes That Have Lower Prices Received Higher Loan Deficiency Payments

In using the marketing assistance loan program, producers of wheat classes that have lower prices could receive higher rates for loan deficiency payments than producers of wheat classes that have higher prices within the same county. This is because USDA has one loan rate for wheat, which is a weighted average of the market prices and acres produced for the five classes of wheat, but five separate posted county prices for each class of wheat—each with a different market value. Some classes of wheat have higher market prices and less production. However, as a result of the single loan rate for wheat and the five posted county prices, producers of classes of wheat that have lower prices (such as soft white wheat during 1998) may have been able to obtain higher rates for loan deficiency payments than producers of classes of wheat that generally have higher prices, such as durum. For example, throughout 1998, durum wheat producers in North Dakota were rarely eligible for loan deficiency payments because the posted county prices were seldom below the loan rate. In contrast, producers of other wheat varieties in North Dakota received an average of \$0.28 per bushel in loan deficiency payments.

In response to this problem, USDA analyzed the impact of using a separate county loan rate for each of the five classes of wheat. USDA has not proposed any changes in the loan rates because some producers' rates would have declined substantially in many counties. Furthermore, USDA did not want to adjust the wheat loan rates without adjusting loan rates for other crops as well.

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### Producers Increased Production of Soybeans Because of USDA's Higher Guaranteed Price

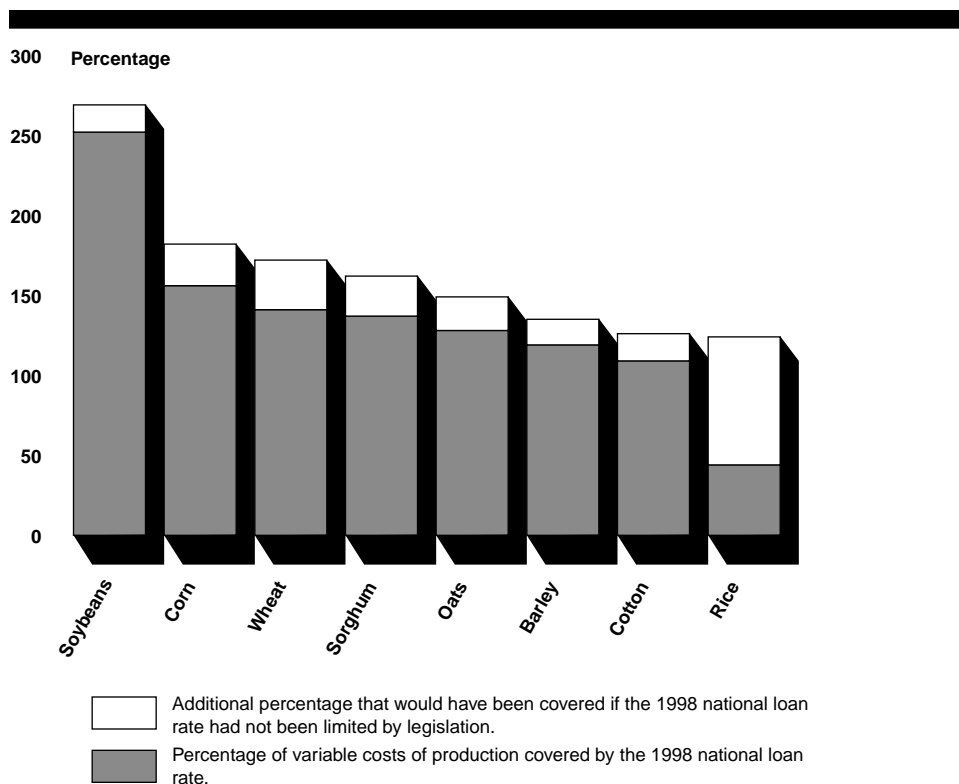
As a result of differences in loan rates in relationship to crop production costs, according to USDA and producers, producers are choosing to grow crops in response to available payments rather than in response to market signals. According to USDA officials, soybean production increased 4 percent in 1999, largely because of the higher net returns associated with the relatively higher loan rate offered for this crop. This view is consistent with interviews we held with producers and county officials.

USDA's loan rates for different crops cover different percentages of production costs because of differences in the congressionally mandated limits on the national loan rates. For example, the national loan rate for

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soybeans covers significantly more of that crop's production costs than do the national rates for wheat and feed grains. Using the national average for variable costs of production as a yardstick, the national loan rate for soybeans covers about 250 percent of variable costs compared with the national loan rates for wheat and feed grains, which cover 120 percent to about 150 percent of variable costs. Figure 6 shows the differences in the variable costs of production covered by the national loan rates for soybeans; feed grains (corn, sorghum, oats, barley); wheat; upland cotton; and rice. As figure 6 shows, none of the other crops has a loan rate offering as high a level of price-to-cost guarantee as soybeans. Figure 6 also shows the differences in variable costs of production that would be covered if the limits on the national loan rates were not in place. In order to resolve these inconsistencies, legislation would be necessary. USDA has not proposed any legislation to change the national loan limits to resolve this problem, but USDA does support adjusting the national loan rates for wheat and feed grains.

**Figure 6: Percentage of Variable Costs of Production Covered by the 1998 National Loan Rates and the Additional Percentage That Would Have Been Covered If the 1998 National Loan Rates Had Not Been Limited by Legislation**



Source: GAO's analysis of USDA's data.

### Some Producers Reached Limits on Cash Payments

According to USDA officials and producers we interviewed, because prices had declined significantly in 1998, some producers reached the annual ceiling of \$75,000 for cash payments. USDA county office officials told us that they expect even more producers to meet this payment limitation during crop year 1999. USDA officials told us they were concerned that when producers reach the payment limitation, they will take out loans and forfeit their collateral. Because such concerns also surfaced in the Congress, the \$75,000 payment limitation was raised to \$150,000 for 1999 crops only with the passage of P.L. 106-78 (Oct. 22, 1999).

### Conclusions

Because of the dramatic decrease in crop prices in recent years, many producers, as would be expected, turned to the marketing assistance loan program as a source of guaranteed income, rather than as a source of interim financing at harvest—the program's original, primary use when

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market prices for crops are lower and typically increase above the county loan rate after harvest. As a result, the program has experienced a huge increase in cost—a more than twentyfold increase between 1997 and 1998 crops. During this time, a number of implementation anomalies and unintended consequences have emerged from several features of the program’s design, such as the process for setting posted county prices and the lack of adjustments to the loan rates by the Secretary of Agriculture to reflect more recent market conditions. These interrelated causes have resulted in marketing inefficiencies. The Secretary of Agriculture can address some aspects of the problem with administrative action. Other issues concerning the program’s design can only be addressed through legislative changes.

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## Recommendation to the Secretary of Agriculture

To respond to the problems producers have encountered in using the marketing assistance loan program and to address the increased potential for loan forfeitures, we recommend that the Secretary of Agriculture develop and implement administrative changes—or, if lacking authority to do this, seek legislative changes from the Congress—to revise the program to provide financing and price guarantees that better reflect market conditions. These changes should address the following: (1) the process to establish and update the national and local loan rates for each crop, (2) the process to estimate local market prices, (3) the cost to the government of these changes, and (4) the financial impact these changes would have on producers in different regions of the country.

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## Agency Comments

We provided a copy of a draft of this report to USDA for its review and comment. We met with officials from USDA’s Farm Service Agency, including the Assistant Deputy Administrator for Farm Programs. These officials generally agreed with the information provided in our report and with the report’s conclusions and recommendation. The agency officials provided technical changes to the report, which we incorporated as appropriate.

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## Objectives, Scope, and Methodology

To determine which producers benefited from the program, by type of crop and state, we reviewed USDA’s files on marketing assistance loans and loan deficiency payments. To determine why producers did not participate in the program, we interviewed USDA officials and producers.

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To assess the issues related to the program's design, we interviewed USDA officials, producers, and grain elevator operators and analyzed data on county loan rates, posted county prices, loan deficiency payments, and the costs of producing crops.

We performed our work at USDA headquarters, the Kansas City Commodity Office, USDA's Farm Service Agency, state and county offices in North Dakota and Texas, and the state office in Iowa. These states were selected because their producers are major producers of eligible crops, such as wheat, feed grains, upland cotton, and oilseeds, and because they have a large number of program participants.

We performed our review from November 1998 through October 1999 in accordance with generally accepted government auditing standards.

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We are sending copies of this report to Senator Richard A. Lugar, Chairman, and Senator Tom Harkin, Ranking Minority Member, Senate Committee on Agriculture, Nutrition, and Forestry; Representative Larry Combest, Chairman, and Representative Charles W. Stenholm, Ranking Minority Member, House Committee on Agriculture; and other appropriate congressional committees. We are also sending copies of this report to the Honorable Dan Glickman, the Secretary of Agriculture. Copies will also be made available to others upon request.

Please contact me at (202) 512-5138 if you or your staff have any questions about this report. Key contributors to this report are listed in appendix I.

Sincerely yours,



Lawrence J. Dyckman  
Director, Food and  
Agriculture Issues

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# GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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