Fact Sheet

March 2006

United States Department of Agriculture

Upland Cotton Direct and Counter-cyclical Payment Program and Marketing Assistance Loans

Direct and Counter-cyclical Payment (DCP) Program

The Farm Security and Rural Investment Act of 2002 (2002 Act) replaced production flexibility contract (PFC) payments (created under the 1996 Act) with direct payments and added new counter-cyclical payments for the 2002-2007 crops. DCP payments are based on historical acreage bases and payment yields, not current production. In addition to upland cotton, other eligible commodities are wheat, corn, barley, grain sorghum, oats, rice, soybeans, other oilseeds, and peanuts.

Landowners had a one-time opportunity to either:

1. Use their 2002 PFC acreage and add acreage bases for oilseeds and peanuts; or
2. Update their acreage bases using the average planted (or prevented from being planted) acreage for the 1998-2001 crop years.

If they chose to update their acreage bases, they could also update their counter-cyclical payment yields using one of the following two methods for the farm:

1. 93.5 percent of the 1998-2001 average yield; or
2. The direct program payment yield (the payment yield in effect under the 1996 Act) plus 70 percent of the difference between the 1998-2001 average and the direct payment yield. Direct payment yields are the same as the payment yields used for making PFC payments.

FSA issues direct payments regardless of market prices. The 2002 Act set the payment rates. For each commodity, the direct payment equals the direct payment rate times 85 percent of the farm's base acreage times the farm's direct payment yield.

FSA issues counter-cyclical payments when a commodity's effective price is below its target price. The 2002 Act set target prices. The effective price is the direct payment rate plus the higher of:

1. The national average market price received by producers during the marketing year; or
2. The national loan rate for the commodity.

Planting Flexibility

A DCP participant can plant any commodity or crop on a farm's contract acreage, except fruits and vegetables (other than lentils, mung beans, and dry peas). However, DCP participants may grow fruits and vegetables under the following circumstances:

1. In any region with a history of double-cropping contract commodities with fruits and vegetables;
2. On a farm with a history of planting fruits or vegetables, except that FSA will reduce the contract payment by an acre for each acre planted to a fruit or vegetable on the farm; or
3. By a producer with an established history of planting a specific fruit or vegetable, except that the area planted may not exceed the producer's average annual plantings in the 1991-1995 crop years (excluding any year with no plantings) and that FSA will reduce the contract payment by an acre for each acre planted to the fruit or vegetable.

Marketing Assistance Loans

Upland cotton producers are also eligible for marketing assistance loans, which provide producers interim financing at harvest time to meet cash flow needs without having to sell their commodities when market prices are typically at harvest-time lows. Allowing producers to store production at harvest facilitates more orderly marketing of commodities throughout the year.

Producers are eligible to receive marketing assistance loans on all

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upland cotton production. For cotton to be eligible for a loan, producers must:

- Comply with applicable USDA conservation and wetland requirements;
- Report their upland cotton planted acreage;
- Comply with crop insurance requirements; and
- Maintain beneficial interest in the cotton from harvest throughout the loan's term.

Further, the upland cotton must be:

- Ginned;
- Carry an approved USDA Agricultural Marketing Service class; and
- Be placed in a Commodity Credit Corporation (CCC)-approved warehouse.

When the loan expires, upland cotton producers may forfeit the cotton to CCC in full satisfaction of the loan.

Beneficial Interest

A producer is considered to have beneficial interest in the cotton if all of the following remain with the producer:

1. Control of the commodity;
2. Risk of loss; and
3. Title to the commodity.

Loan Rate

The 2002 Act specified the upland cotton loan rate at 52.00 cents per pound. The 2005 loan rate for Strict Low Middling (SLM) 1 and 1/16 inch upland cotton, leaf grade 4, micronaire 3.5-3.6 and 4.3-4.9, strength 25.5 through 29.4 grams per tex, and length uniformity of 80-82 percent at average U.S. location (base quality) is 52.00 cents per pound.

Loan Terms

Loans are available for a term of nine months beginning the first day of the month after the loan is made. Loan extensions beyond nine months are not authorized. The last date to request a loan on 2005-crop cotton is May 31, 2006.

Adjusted World Price and Step 1

The Adjusted World Price (AWP) is equal to the Northern Europe (NE) price (the five-day average of the five lowest-priced growths for Middling [M] 1-3/32 inch cotton, cost, insurance and freight [CIF] northern Europe), adjusted to U.S. base quality and average location.

The AWP for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer. The AWP and CCA are announced each Thursday.

A Step 1 adjustment to the AWP may be made when the five-day average of the lowest U.S. growth quote for M 1-3/32 inch cotton, CIF United States-Northern Europe (USNE) price, exceeds the NE price and the AWP is less than 115 percent of the loan level. The Secretary of Agriculture may lower the AWP up to the difference between the USNE price and the NE price.

Loan Repayment Rate

The loan repayment rate is the lower of the loan rate or the AWP, less any applicable CCA in effect at the time the producer repays the loan.

Loan Deficiency Payments

When the AWP is below the loan rate, eligible producers who agree to forego CCC loans may receive Loan Deficiency Payments (LDP). All of the eligibility requirements listed for marketing assistance loans also apply to LDP eligibility, except that the cotton does not have to be ginned or warehouse-stored.

Producers can lock in their LDP rate prior to ginning while the seed cotton is in ricks, modules, or trailers by providing module numbers at the time of application. FSA disburses LDPs after the cotton is ginned. Another exception can be made to the beneficial interest requirement for cotton being sold direct from the gin if producers apply for the LDP at their FSA county office in advance of ginning.

The LDP rate is equal to the difference between the loan rate

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and the loan repayment rate in effect during the week in which the producers files the payment application. LDPs are subject to the payment limitation. Producers are allowed to participate in the LDP program on a bale-by-bale basis.

Storage and Interest Policies

In general, producers must pay interest charges when they repay the loan. Producers are also responsible for all charges accrued at the warehouse. However, CCC waives interest charges and pays some or all of the loan period storage charges necessary to make the loan repayable at the lower of either:

1. The loan rate plus storage and interest costs; or
2. The AWP.

If the producer forfeits the loan to CCC, no interest is charged and CCC assumes responsibility for the warehouse storage charges that accrued during the cotton loan period. At forfeiture, the producer pays unpaid receiving charges and unpaid storage charges outside of the loan period.

CCC Domestic Sales Policy

CCC may sell any cotton in its inventory at any price the Secretary of Agriculture determines will maximize returns to CCC.

For More Information

More information on DCP and marketing loans for upland cotton is available at FSA county offices and on FSA's Web site at: www.fsa.usda.gov