COMMENTS ON 1983 CROP PROGRAMS

Staff Memorandum

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THE PIK PROGRAM

The PIK program provides for payments in commodities to farmers who divert acreage over and above that required by the acreage reduction program and paid acreage diversion program. The stated purpose of PIK is to reduce production through a further cutback in planting; this would decrease surplus stocks, bring supply more in line with demand, and strengthen farm income in future years. The PIK program is held to be a means of achieving these purposes while avoiding increases in price support outlays.

There is much uncertainty about how the current 1983 crop programs will affect farmers and taxpayers. This uncertainty is compounded when assessing the incremental effects of the PIK program relative to the initial reduced acreage and paid acreage diversion programs. The principal source of this uncertainty is the extent to which farmers participate in the PIK program.

Farmer Participation

The final sign-up date for farmers to participate in the 1983 crop programs was March 11, 1983. A recent survey indicates that participation in the corn program may be substantially greater than most analysts have anticipated. However, the Department of Agriculture will not release enrollment information until March 22, 1983. At that time, we will know the number of farms and the number of acres enrolled in each of the production-related programs--reduced acreage, paid acreage diversion, and PIK. This will provide a rough upper bound on the number of acres that could be withdrawn from cultivation by farmers participating in these 1983 programs. But even then, some variation in outcome is possible for two reasons.

First, we will not know the extent to which those farmers who sign up to participate in the reduced acreage and paid acreage diversion programs will actually do so. These farmers, unlike those who also sign up for PIK, do not face a financial penalty for later deciding to withdraw from the programs. Last year, for example, about half the base acres initially enrolled in the corn and wheat reduced acreage programs were eventually withdrawn. It is not clear, however, whether that experience would be repeated under current conditions. Second, planting decisions of nonparticipating feed grain, rice, and cotton farmers will not be clear at that time. These have a direct influence on the effectiveness of these programs because increased production could offset the results of acreage withdrawal.

Despite these limitations, it is possible to make a preliminary assessment of the potential consequences of the PIK program based on current expectations.

Possible Price Effects

We currently expect that the PIK program will increase the amount of acreage diverted from crop production in 1983. With everything else constant, this would lead to smaller crop production and cause total stocks to decline in 1983. A reduction in stocks from expected levels normally leads to higher prices, particularly when stocks are low relative to use. Now, however, stocks are not low: 1982 ending wheat and corn stocks are expected to approximate about 65 percent and 50 percent of use, respectively, substantially above normal levels. This suggests that the short-term price effect of lower stocks may be diminished.

As important as the aggregate level of stocks is their distribution. The PIK program may shift the distribution of stocks away from the Commodity Credit Corporation (CCC), the farmer-owned reserve, and toward "free" stocks. It is these so-called free stocks that appear on the market and directly influence near-term prices. Free stocks would probably change little in the absence of the PIK program, since grain produced on PIK acreage would otherwise go into the reserve. However, payments-in-kind will increase free stocks because commodity payments will be made from either CCC stocks or from the farmer-owned reserve. Typically, increases in free stocks weaken prices, especially if farmers elect to sell PIK crops immediately, rather than holding them. Thus, the addition to free stocks could offset the price-increasing effects of smaller total stocks, and as a result, the PIK program may have a small impact on 1983 crop prices.

If, in fact, the PIK program has little effect on prices, then crop farmers' net returns will be mainly influenced by the fact that they receive revenues from the PIK commodities without incurring their production costs. In this manner, the PIK program should act to increase net returns for participants above what they might have been otherwise.

Effects on Farm Suppliers

Smaller planted and harvested acres mean reduced sales and incomes for businesses that sell fertilizer, seed, fuel, pesticides, machinery, and other production items to farmers. The Department of Agriculture has estimated that the PIK program will reduce sales of seed and pesticides by 5 to 7 percent; fertilizer 4 to 7 percent; fuel 2 to 3 percent; and farm machinery less than 1 percent. In addition, smaller crops may also mean smaller business volumes for marketing and processing firms.

Budget Implications

From a budgetary viewpoint, the estimated effects of the PIK program are mixed. On the one hand, the CBO estimates that the PIK program (applied to both the 1983 and 1984 crops) would save $325 million in fiscal year 1983, $2,260 million in fiscal 1984, and $2,400 million in fiscal 1985 as compared to outlays under the reduced acreage and paid acreage diversion programs alone. Most of these estimated outlay savings would occur because the PIK program would reduce loans and deficiency payments.

On the other hand, the CBO estimates that the PIK program would increase realized losses by a total of $4.8 billion--$2.0 billion in fiscal year 1983 and $2.8 billion in fiscal 1984. These realized losses, or unrecoverable outlays, occur in two ways. First, the payments-in-kind could come from CCC inventories. If that were the case, the CCC would receive nothing for an asset that it acquired by allowing farmers to forfeit their nonrecourse loans. Second, the payments-in-kind could come from the farmer-owned reserve. In that case, the CCC would forego any repayments for the loans made on these crops. In either case, the accounting treatment would be similar to a write-off taken for a bad debt.

Whether these realized losses imply that the PIK program is likely to be a net cost to the government depends upon the view taken of the value of the commodities in government storage. The realized loss of $4.8 billion in fiscal years 1983 and 1984 presupposes that the commodity payments can be valued at the cost of the foregone loan repayments. From an accounting perspective, that value is correct since the loan funds available to the CCC must be restored, either through repayment by farmers or through government restoration of the losses. Alternatively, the payment-in-kind commodities could be considered as having no value at all because chronically weak markets for agricultural products would eventually lead to some form of uncompensated disposal. Thus the $4.8 billion simply represents an accounting loss that must be realized at some time; and realization at present would avoid further storage charges.

CBO BASELINE PROJECTIONS

As shown in the following table, the CBO baseline projections for agriculture that were presented to the Budget Committee on February 9, 1983 differ from the Administration's current services projections. Much of this difference results from two policy assumptions.

TABLE 1. AGRICULTURAL PRICE SUPPORT AND RELATED EXPENDITURES BY FISCAL YEAR (In billions of dollars)

	1983	1984	1985	1986	1987	1988
Administration's Current Service Projections	18.8	12.3	13.7	13.4	14.6	12.5
CBO Baseline Projections	17.6	9.1	7.5	4.6	4.7	4.9
CBO Revised Baseline Projections	18.2	10.4	9.9	10.8	11.2	11.7

First, neither the CBO nor the Administration projections incorporated the effects of the PIK program. Second, the Administration assumed a continuation of the 1983 crop programs as mandated by the 1982 Reconciliation Act. Under this assumption, the paid diversion programs are quite expensive--about $1.4 billion in payments each year--and not very effective--ending stocks are projected to remain large and prices are expected to increase only slightly above the loan rates for wheat and corn. By contrast, the CBO assumed that no diversion program would be offered without legislative action; instead, a restrictive set-aside program was assumed. A 25 percent acreage reduction for wheat and 20 percent for feed grains, cotton, and rice was assumed for the 1984 crop year, and low market prices and high target prices were assumed to provide incentives for strong participation. These restricted planting programs were assumed to be decreased to 20 percent in 1985 and 10 percent in both the 1986 and 1987 crop years as supply and demand came into balance. Ending stocks were projected to decline modestly, and 1987 crop prices to increase.

In addition to these differences in policy assumptions, technical estimating differences about export growth, crop yields, and effectiveness of set-aside programs resulted in tighter supplies, higher prices, and smaller outlays in the CBO baseline.

The CBO has since revised its baseline projections, including a PIK program in both 1983 and 1984 crop years. No paid diversion program is assumed after 1983, consistent with the President's budget projections and

with announced PIK programs. The CBO has also lowered export projections to reflect declining expectations for 1983. As shown in Table 1, outlays under these revised baseline assumptions decline from $18.2 billion in fiscal year 1983 to $9.9 billion in fiscal year 1985 and average $11.2 billion for the next three years. These revised baseline projections, while below fiscal year 1983 levels, are more than three times larger than average outlays over fiscal years 1968-1981.

IMPLICATIONS IN SUMMARY

The PIK program could induce additional acreage out of crop production by paying farmers in commodities rather than cash. Although this is not a new policy approach, we cannot yet be certain of how it will compare to paid acreage diversion or how it will affect crop farmers and taxpayers. However, it is clear that unlike cash payments, commodity payments will have a direct effect upon the distribution of stocks. Consequently, the PIK program has the potential to keep short-term prices from increasing even as it reduces total stocks.

Despite the assumption of continued acreage reduction programs in the revised baseline projections, price support outlays remain high relative to historic levels. Therefore, from the viewpoint of farm prices and the federal budget, some type of additional reductions in plantings for the 1984 crops might be considered.

An alternative to current programs is mandatory acreage reduction. As discussed in the CBO budget reduction paper, 1/ mandatory acreage reductions for 1984 crops could be more effective in reducing excessive supplies, strengthening prices, and reducing outlays. Mandatory acreage reduction might be seen as more equitable since it would require all farmers to share in the adjustment to weak markets for agricultural commodities. However, such a policy would be in sharp contrast to the long term policy transition which has reduced government intervention in crop farming.

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1. Congressional Budget Office, Reducing the Deficit: Spending and Revenue Options, February 1983, p. 143.