Issue. Federal budgetary outlays for commodity income and price support programs are expected to be sharply higher in 1993. This will bring farm program spending under closer scrutiny as Congress and the executive branch look for ways to reduce the budget deficit. Deficiency payments, which compensate farmers for differences between target prices and market prices for grains and cotton, account for more than one-half of commodity program spending. A number of options to reduce outlays for deficiency payments are being suggested by policymakers. Economic implications for agriculture may differ by option.

Context. Deficiency payments are entitlements; that is, spending is determined by rules that define eligibility and govern benefit levels rather than by the annual appropriations process. USDA and Congress have no control over deficiency payment outlays once annual programs are announced. Outlays under an announced program are determined by the extent of participation in the program and the market price level.

Producers of wheat, corn and other feed grains, cotton, and rice are eligible for deficiency payments whenever the target price for the commodity exceeds the average market price during a specified time period. To be eligible for deficiency payments and other program benefits, producers must participate in any acreage reduction program (ARP) in effect for the commodity.

The deficiency payment to a producer equals the deficiency payment rate for the commodity (target price minus market price) multiplied by the farm's program production (per acre program yield for the farm times payment acres). Under current law, payment acres generally equal 85 percent of the farm's established acreage base for the crop, less any land that must be idled to comply with the ARP.

The unpredictable nature of entitlement spending is illustrated by forecasts for fiscal 1993. Commodity program outlays for 1993 were forecast at $11.7 billion by the Office of Management and Budget in early 1992; by January 1993, the forecast had risen to $17.1 billion. The increase was due in part to larger deficiency payments for corn and cotton, as market prices were lower than had been expected. Commodity program outlays in fiscal 1993 likely will be the largest since 1987 and 75 percent more than fiscal 1992 outlays.

At Stake. Farm income is affected by deficiency payments. Income from production of program crops will decline if deficiency payments are reduced. Deficiency payments are expected to exceed $9 billion in fiscal 1993, an amount equal to 30 percent of cash market receipts from grain and cotton crops. Since deficiency payments are regionally concentrated, cuts in payments can affect rural communities.

Alternatives. Government could act to reduce deficiency payments in various ways. Some actions may be done administratively; others would require legislation. Deficiency payment rates may be lowered by a legislated reduction in target prices or by administrative actions to raise market prices. Administrative actions include raising ARP requirements and price supports (loan rates) to the higher end of their allowed ranges. Higher ARP's raise market prices through cuts in production and also...
reduce the amount of acres eligible for deficiency payments. Higher loan rates lower deficiency payment rates when U.S. market prices are at or near loan rate levels. However, raising loan rates above world prices would make U.S. commodities less competitive, may increase Commodity Credit Corporation outlays for marketing loans, increase the costs of export promotion programs, and lead to costly stockbuilding in the United States. Higher ARP’s also would cut the U.S. export market share and increase the costs of export programs.

Acreage eligible for deficiency payments also may be reduced by legislation to expand the provision in the Omnibus Budget Reconciliation Act of 1990 that made 15 percent of each program crop acreage base ineligible for deficiency payments. This change was intended to reduce program spending and to increase producers’ planting flexibility. A producer is permitted to plant any program crop or oilseed on unpaid base acreage and by doing so maintain the base for future program benefits. The 15-percent unpaid base acreage is commonly called "normal flex acres" or NFA.

Reducing deficiency payments either by cutting target prices or by increasing the NFA percentage has fewer economic side effects than other options discussed above. The effect of a percentage cut in target prices on deficiency payment rates, and thus outlays, is difficult to predict. For example, a 3-percent cut in target prices would lower the payment rate by 10 percent when the commodity market price is 70 percent of the target price, and by 30 percent when the market price is 90 percent of the target price. Because the ratio of market price to target price may vary substantially across commodities, a general reduction in target prices may be an unwieldy option for achieving a specified cut in deficiency payments.

Reducing payment acres by raising the NFA percentage may be a more straightforward method for attempting a specified cut in deficiency payments. Moreover, deficiency payments would be smaller under this option, compared with the target price option, in the event of an unexpected drop in market prices: the additional deficiency payment rate would be paid on a smaller quantity. This option would enhance market orientation of U.S. crop production as market prices would guide farmers’ planting decisions on a larger acreage. However, ARP participants may shift to production of nonprogram crops on the unpaid base acres, thereby lowering prices of nonprogram crops.

From the taxpayers’ standpoint, the potential for large deficiency payment outlays is present each year due to the entitlement status of the payments. This potential would exist, though to a lesser degree, even if target prices were reduced or payment acres were cut further through an increase in the NFA percentage. An unanticipated drop in market prices would raise deficiency payment rates and outlays above forecasts. Either of the options would reduce payment outlays from the level they otherwise would be, but there would be no guarantee that they would stay within budgeted amounts. This could lead to a proposal to end entitlement status and limit outlays to an appropriated level.

**Agenda.** The Clinton administration has proposed that the NFA percentage be increased to 25 percent beginning in 1996. This issue will be debated at both the executive and legislative levels.