Payment in Kind—New Life for an Old Idea

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The payment-in-kind (PIK) program, recently put in effect for several 1983 crops, gives a new twist to an old idea—paying farmers with agricultural commodities instead of cash to reduce excess Government stocks.

If successful, the PIK program will strengthen farm prices without having much effect on consumer prices and should reduce both the number of bushels acquired under Federal price support activities and the amount of tax money that must be spent for storage and price supports. Retail food prices for 1983 are expected to advance only 2 to 4 percent compared with 4 percent last year. Market supplies of commodities included in the program (wheat, corn, grain sorghum, rice, and cotton) should not be much lower than last year, since farmers will sell the commodities they receive for land taken out of production. For the 1984 fiscal year, USDA expects to save about $3 billion on its price support operations, mostly from lower storage costs.

Surplus production has become one of the most serious problems facing American agriculture in recent years, lowering farm income, forcing greater reliance on uncertain export markets, and raising Government expenditures. Consumers, like farmers, have a vested interest in seeing surpluses brought under control before they detract from U.S. agricultural efficiency, which keeps supplies adequate and prices reasonable. With this in mind, let's take a look at PIK and how it evolved.

The new program launches a twofold attack on the problem—it, along with two previously announced diversion plans, substantially diminishes the acreage planted in the commodities where surpluses are greatest and lowers the Government's stocks by making payments to farmers in the same crops that they ordinarily grow. Some 82 million acres—about 35 percent of recent plantings—have been pledged for retirement this year.

Payments in kind became necessary because of the deteriorating economic position of farmers and the rapid escalation of Federal expenditures for agricultural programs. A surge in exports beginning with the Soviet grain sale of 1972 caused a shift in USDA programs. Instead of aiming to prevent surpluses, the Government began to encourage all-out production. Farmers prospered as prices rose well above support levels. Total Government payments to farmers dropped from nearly $4 billion in 1972 to below $1 billion a year in the mid-1970's. Toward the end of the decade, however, prices declined as production increases outstripped demand.

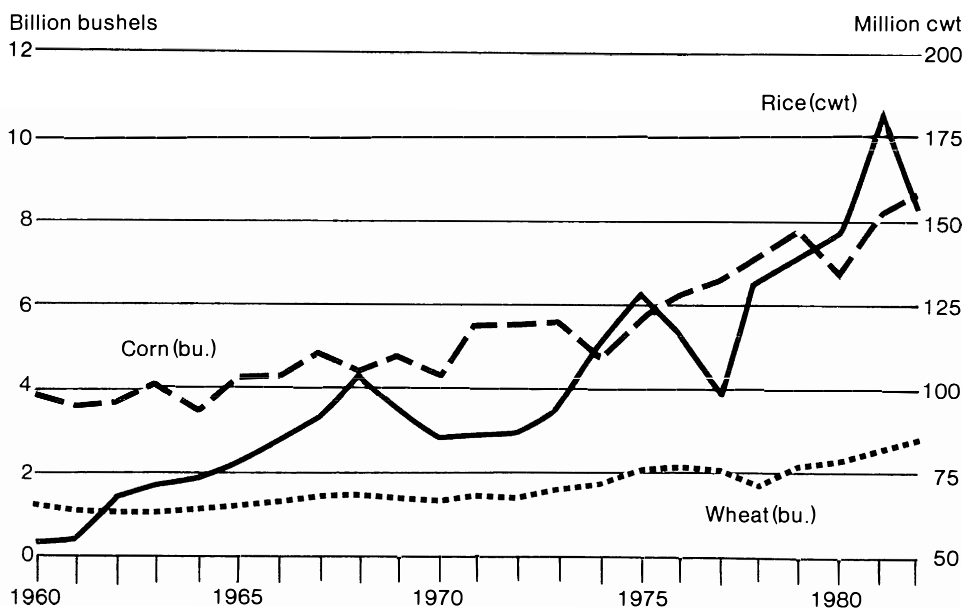
In the early 1980's, export demand began to weaken because of the strong dollar, worldwide recession, and unusually large surpluses overseas. The value of U.S. farm exports fell 10.7 percent in 1982. USDA estimates that, without PIK, by the end of the 1982/83 production year U.S. stocks of wheat would be double and feed grains (corn, grain sorghum, barley, and oats), cotton, and rice would be triple their 1980/81 levels.

Net farm income has dropped from $25.1 billion in 1981 to a projected low of $20.4 billion in 1982. Corn and wheat that brought $2.70 and $3.88 per bushel as recently as 1980 were selling for just $1.98 and $3.43, respectively, in October 1982. Low income combined with high interest rates have put farmers in a credit squeeze.

Meanwhile, the cost of USDA's price support operations soared. After passing the $1 billion mark again in 1977, payments to farmers topped $3 billion in 1982. Commodity Credit Corporation (CCC) acquisitions increased at the same time, as prices fell below support levels.

To address these problems, the Department chose PIK in preference to other options because it will simultaneously reduce expenditures, production, and stocks while holding out the hope of higher prices for farmers. Moreover, PIK is more in line with the Administration's preference for a more market-oriented agriculture because, while price supports

Figure 1. Annual U.S. Production of Wheat, Corn, and Rice



Source: U.S. Department of Agriculture.

will continue, farmers will be given an unusual number of options for the planting and disposal of their crops.

The Old PIK

PIK is not a new concept, nor does it address a new problem. In the late 1950's and early 1960's, agriculture also had to contend with massive surpluses. High Government price support policies in the 1950's had encouraged farmers to produce far more than the market could absorb. Despite a decline in supports and an acreage diversion ("Soil Bank") program in the late 1950's, production of feed grains had continued to climb.

Partly to address the surplus problem, Secretary of Agriculture Ezra Taft Benson began using payments in kind in 1956 by shifting the subsidy paid to wheat export firms from cash to kind. Feed grains, cotton, and rice followed in 1958, dry milk products were added in 1962. But this form of PIK did not do enough to reduce Government holdings, and by the late 1950's the CCC's corn inventories had grown to a record 1.26 billion bushels. To make a substantial dent in Government stocks, a domestic PIK program linked to a reduction in acreage would be necessary.

In 1961, Secretary Orville Freeman revived an idea that had been tried briefly in the 1930's—converting Government price supports to in-kind payments. Farmers participating in price support programs who agreed to idle more than 20 percent of their corn and grain sorghum acreage would be entitled to receive a payment in kind for their additional diversion. This proposal aroused quite a bit of controversy because the Secretary also requested sweeping authority to release CCC stocks at market prices instead of the higher rate mandated by law. Many farmers feared that large sales of grain by the Government would severely depress market prices.

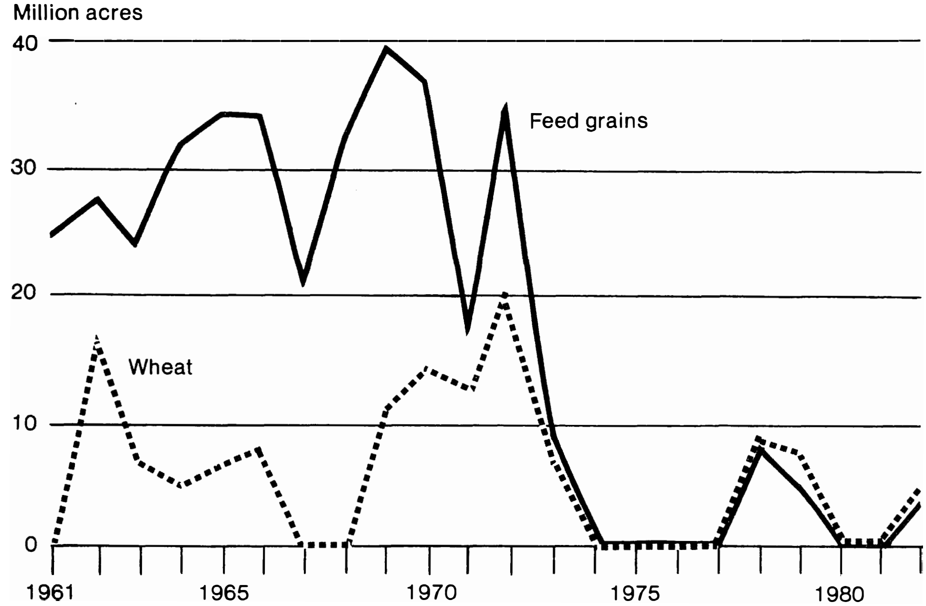
As finally passed by Congress, the Feed Grain Program of 1961 set up a payment-in-kind arrangement for corn and grain sorghum producers which permitted those diverting 20 percent of their 1959 base acreage to take an additional 20 percent out of production for a payment in kind equal to up to 60 percent of their normal yield. Farmers were paid with negotiable government certificates which could be redeemed for the commodity itself or for its cash value, in which case the CCC sold the grain at market prices. The great majority of farmers chose to receive cash.

The 1961 Feed Grain Program attracted enough participants to take over 25 million acres out of production. This amounted to a 19-percent drop in planted corn acreage and a 27-percent drop in planted grain sorghum acreage between 1960 and 1961. In 1962, PIK was expanded to include barley and, in 1963, oats. From 1962 on, a total diversion of up to 50 percent was allowed and even price supports began to be paid partly in kind. The Food and Agriculture Act of 1965 renewed PIK for several years. In 1970, after CCC inventories had been at satisfactory levels for several years, PIK was allowed to expire. A PIK cotton program was also in effect briefly between 1965 and 1967.

The payment-in-kind programs of the 1960's were generally successful. The amount of land planted with crops in the program remained well below pre-PIK levels in most years. Total production, though, did not drop as much as originally hoped because in the early and mid-1960's average yields per acre advanced sharply for many crops due to use of better seeds, more fertilizer, and the fact that farmers usually selected their poorest lands for diversion. This was especially true for corn where the 1960 average yield of 54.7 bushels per acre jumped to 73.8 bushels by 1965. As a result, after an initial drop of 7.9 percent, corn production actually increased slightly between those years even though farmers harvested 16 million fewer acres.

The effect of PIK on prices is harder to determine. Critics charged that the CCC kept farm prices low by selling payment-

Figure 2. Land Diverted from Production, Feed Grains and Wheat



Source: U.S. Department of Agriculture.

in-kind grain at whatever the market would bring. Average prices did remain low through the 1960's. But, because of production controls, smaller inventories, and higher foreign demand, prices after 1961 regained part of the ground lost in the late 1950's. Corn, for example, sold for $1.29 a bushel in 1956, slid to $1 in 1960, and then recovered to $1.17 in 1964. Grain sorghum brought $1.15 per bushel in 1956, $0.84 in 1960, and $1.05 in 1964. The story for barley and oats was similar. Cotton, though, fell in value between 1964 and 1966 despite the short-lived cotton PIK program. Had the PIK diversion program not been in effect, higher production would have put prices under greater pressure. Meanwhile, farmers within the Government's price support program enjoyed a solid increase in returns—from $1.06 per bushel of corn in 1960 to $1.25 in 1964 and $1.35 in 1967. Other price supports went up in a similar fashion. PIK's effect on consumer prices appears to have been small.

The New PIK

The new PIK program is much like the one from the 1960's, but with some important differences. As before, payments in kind are made for a voluntary withdrawal of acres from planting over and above the diversion required to receive price supports. In addition to the mandatory diversion of 20 percent for most crops, participants can also idle between 10 and 30 percent more of their wheat, corn, grain sorghum, rice, or cotton land for payments in kind.

But, unlike the earlier PIK, this one promises to be a true payment in kind. Whereas the great majority of farmers in the 1960's cashed in their PIK certificates and let the CCC market the grain, now farmers must actually take delivery of the commodity at their farms or at a local elevator. This is much more practical now than in years past because today more commodities are stored on the farm instead of in off-farm elevators. Farmers will receive their commodities at their normal harvesttime, either from the nearest elevator with Government owned stocks or from their own storage facilities if they have crops under loan. The Government will pay delivery charges.

Incentives for joining the PIK program are substantially greater now than before. In fact, this may be the most attractive diversion program ever offered farmers. Participants will receive 80 percent of their normal yield for PIK acreage except for wheat where, because much of it was already in the ground when the program was announced, payment will equal 95 percent of normal yield. This compares with a maximum for feed grains of 60 percent in 1961 and just 50 percent in subsequent years. In addition, farmers not immediately selling their PIK commodities will be paid storage costs for up to 5 months after delivery.

Federal crop insurance against natural disasters has also been made more attractive to participants. The $50,000 payment limit per farmer that normally applies to price support programs will not affect PIK payments. Furthermore, farmers in the new PIK program had an option unavailable before—they could submit bids to retire their whole planting of PIK crops. For 1983, 22 million acres have been signed up under this provision.

The results of the PIK program are difficult to predict but past experience and the administration's projections give at least a good idea of what is likely to happen. Production of PIK crops is expected to drop between 17 percent for grain sorghum and 33 percent for corn from last year, substantially higher than in the 1960's. These figures include both PIK and the regular diversion program announced last year. Whether production falls that much, PIK will certainly bring a sharp drop in Government-held stocks. Indeed, the payments in kind are substantial enough that the plan is not expected to be needed after 1984. The Administration projects that the fall in production combined with smaller surpluses of commodities will bring somewhat higher farm prices by next year. Wholesale prices of most PIK commodities have already risen since the program was announced in January. Overall retail food prices, though, will probably not increase more than 2 to 4 percent in 1983 and supplies should be adequate. In addition are the projected budget savings of $3 billion in fiscal year 1984. Not only will the CCC spend less for storage, it will not have to face the problem of how to dispose of deteriorating crops when market prices are well below the level at which the CCC is ordinarily required to sell them.

Another benefit will be in conservation. At a time when environmentalists have become increasingly concerned about the effects of full production on farm land, PIK and related diversions should remove some of the most fragile land from cultivation and put it into conservation uses.

The impact of PIK on local economies is more debatable. Seed, fertilizer, and farm implement producers and dealers have expressed concern that smaller plantings will hurt their businesses. In the case of the financially troubled farm machinery manufacturers, the result could be continued sluggish equipment sales for another year. But in the 1960's, when about as much acreage was affected, complaints about the effects of PIK on farm suppliers seem to have been rare. Overall sales of farm machinery and fertilizer grew steadily during the 1960's. Moreover, this PIK program has safeguards to prevent too much land from being taken out of production in any one area—no more than half the base acreage for any crop can be retired in any one county. If it works as hoped, farm income will be higher, not lower, and local businesses should ultimately benefit. □

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