United States General Accounting Office

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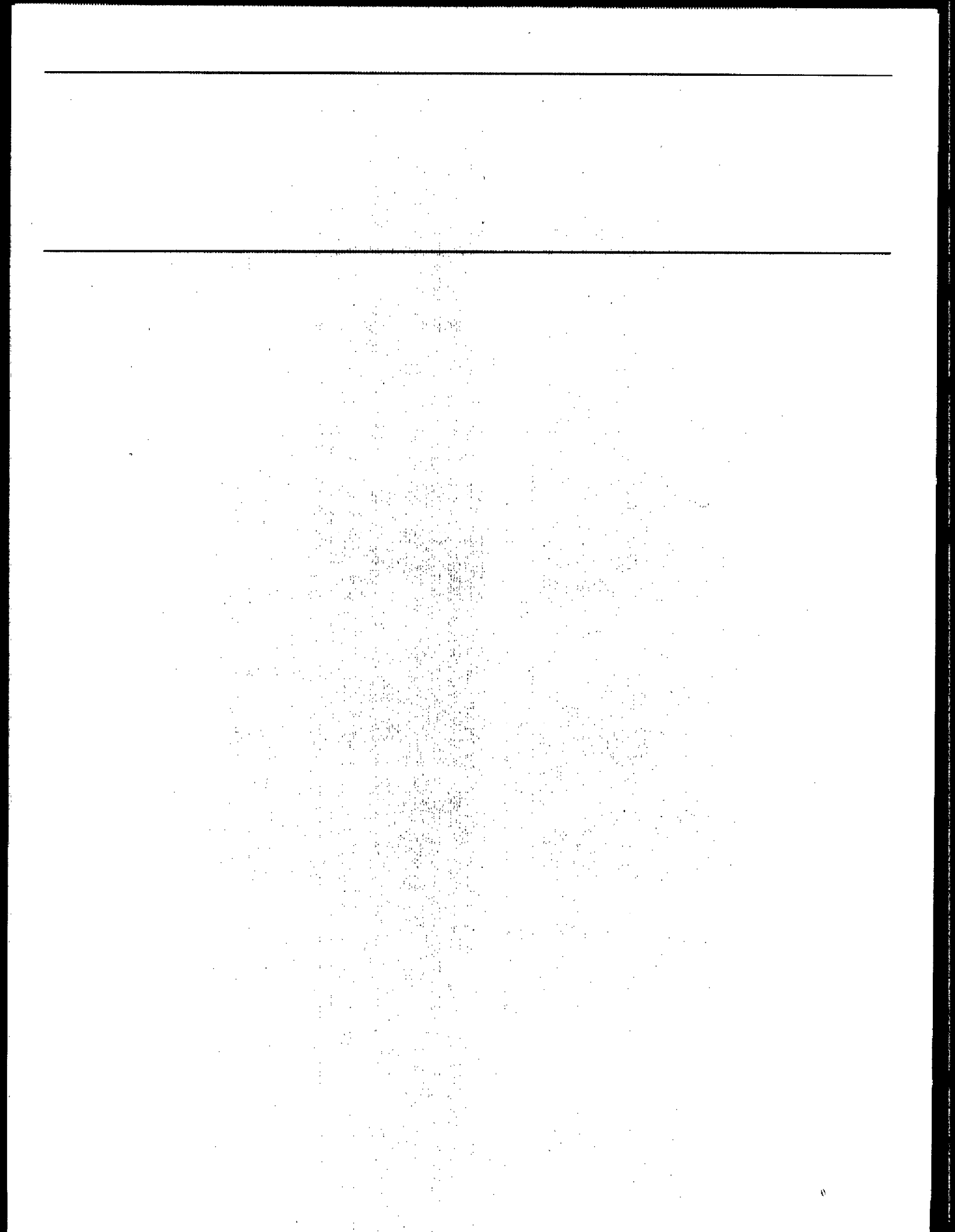
Report to the Honorable
Charles E. Grassley, U.S. Senate

December 1993

COMMODITY PROGRAMS

Flex Acres Enhance Farm Operations and Market Orientation

GAO/RCED-94-76



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United States
General Accounting Office
Washington, D.C. 20548

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Resources, Community, and
Economic Development Division

B-255676

December 30, 1993

The Honorable Charles E. Grassley
United States Senate

Dear Senator Grassley:

In the Food, Agriculture, Conservation, and Trade Act of 1990 (Farm Bill), the Congress provided farmers with greater ability to respond to market signals by allowing them to plant crops other than their designated program crops on up to 25 percent of their base acres.[1] This flexibility was one of the principal elements in the overall strategy of the 1990 farm legislation aimed at improving U.S. competitiveness in the international agriculture market. A second piece of legislation, the Omnibus Budget Reconciliation Act of 1990 (Budget Act), was designed to reduce government expenditures for agriculture programs by providing for the elimination of income support payments on 15 percent of the base acres, even when the designated program crops are planted on these acres. Taken together, the Farm Bill and the Budget Act provisions establish what are commonly called flex acres.

In your February 2, 1993, letter, and in subsequent discussion with your office, we were asked to analyze whether these 1990 legislative changes reduce government costs and are the type of agriculture policy reforms that allow U.S. farmers to be more flexible and more responsive to market demands.

Production data are available for only 1 complete year of operation under flex acres. Furthermore, not all farmers are familiar with how flex acres work. Given these limitations, we describe in this report, to the extent possible, the impact of flex acres on the budgetary and economic costs of the U.S. Department of Agriculture (USDA). As agreed with your office, because it is not feasible at this time to use an economic model to evaluate the impact of flex acres on USDA's programs or farmers, we spoke with USDA officials in headquarters and in 11 states about the use of flex acres in various counties and across different commodities.

Results in Brief

According to USDA projections, flex acres and other legislative changes will reduce government costs by about $12 billion from 1991 through 1995.

[1]Base acres refer to land that is enrolled in the U.S. Department of Agriculture's various commodity programs.

Furthermore, according to most of the USDA officials we spoke with, while farmers dislike losing a portion of their deficiency payments, they generally like the increased flexibility they gain from flex acres and believe that the overall impact on their operations is positive. This flexibility may not always compensate farmers for their lost deficiency payments, but some farmers have increased their income by using flex acres to plant alternative crops with higher returns. Farmers taking advantage of the flex acres obtain other benefits as well, such as improving crop rotation practices, adjusting crop plantings in response to weather conditions, meeting conservation compliance objectives, and increasing farm efficiency. In addition, the flexibility to grow crops outside of the rigid requirements of the federal income support programs gives farmers the opportunity to use their land to respond to the needs of the market.

The net economic impact of flex acres is inconclusive at this time. However, in light of the generally positive views of farmers, expressed by USDA officials, and the projected savings to the federal government, we see no reason why flex acres should not be continued or expanded in future farm legislation. This is consistent with positions we have taken in past reports where we have recommended flexibility as a way to transition from current high-cost programs to programs that are more responsive to market forces.

Background

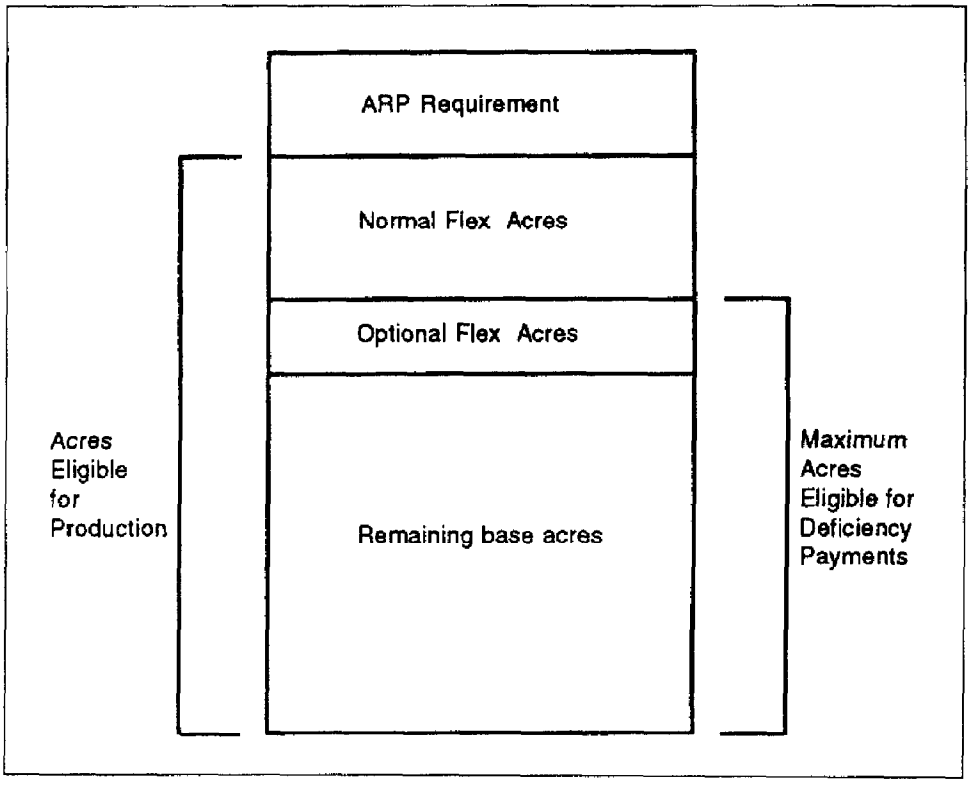
Prior to the 1990 legislative changes, farmers were generally required to plant only designated program crops[2] in order to maintain their crop bases and receive income support payments—known as deficiency payments—from the government. Stringent production control regulations discouraged farmers from producing certain crops, even when commercial market conditions were favorable. To control production, federal farm programs require farmers to establish an acreage base (base acres) for their program crops as a condition for receiving benefits. The government then uses acreage reduction programs (ARP) to limit the planting of the program crops on a specified percentage of the base acres and calculates deficiency payments generally on the basis of the land in production.

As part of the 1990 legislation, flex acres were created to give farmers the flexibility to plant alternative crops on up to 25 percent of their base acres. At the same time, the farmers were allowed to maintain their crop bases as long as they continued to comply with the other requirements of the commodity programs. For 15 percent of a farmer's base acres, known as

[2]Program crops include wheat, corn, barley, oats, grain sorghum, rice, and cotton.

normal flex acres, the farmer is ineligible to receive deficiency payments regardless of whether the designated program crop or another crop is planted. The Farm Bill also allows farmers flexibility on an additional 10 percent of their base acres, known as optional flex acres. Farmers receive deficiency payments on the optional flex acres only if they plant the designated program crops. Farmers will not receive payments on optional flex acres if other crops are planted. Farmers can use flexibility to plant alternative crops (except fruits, vegetables, and other crops specifically prohibited by the Secretary of Agriculture) or to idle the land while protecting the base acres for future years and maintaining eligibility for other benefits of the programs, such as loans. Figure 1 illustrates the various components of the crop acreage base as they relate to planting flexibility.

Figure 1: Components of the Crop Acreage Base



Note: The proportions shown in the figure are not intended to be representational.

In 1992, 167.1 million base acres were enrolled in USDA's commodity programs. Of these, 41.8 million were flex acres (25.1 million acres were designated as normal flex acres and 16.7 million acres were designated as optional flex acres). For computing deficiency payments, normal flex acres are separate from acres removed from production under ARP. For example, if a farmer with a 100-acre base has 10 percent affected by an ARP and 15 percent as normal flex acres, the farmer can receive deficiency payments on no more than 75 acres (100 base acres minus 10 ARP acres minus 15 normal flex acres).

Flex Acres Reduce Government Costs

USDA estimates that flex acres will result in significant savings to the government. According to USDA testimony in April 1993, the reduced deficiency payments attributable to flex acres, together with other program changes, would reduce USDA's commodity program expenditures by about $12 billion from what they otherwise would have been during the years 1991 through 1995. USDA projected that during this 5-year period, government costs for income support programs without the provisions of the 1990 acts would amount to about $72 billion, whereas with the provisions, the costs would amount to about $60 billion.

In addition to reducing government costs, flex acres have the potential to reduce economic inefficiencies in U.S. commodity programs caused by ARPs. ARPs are used to control production, and they create inefficiency because they require farmers to idle productive land. When farmers use flex acres to plant an alternative crop rather than the base crop, USDA could require farmers to idle fewer acres under an ARP to control production of the base crop, thereby reducing the economic inefficiency. However, if farmers choose to idle their flex acres, the economic effect is the same as if the land had been removed through an ARP.

The Impact of Flex Acres on Farm Income Is Unknown

Readily available data on the use of flex acres are not adequate to measure the impact of flex acres on farm income.[3] However, discussions with USDA officials in headquarters and 11 states suggest that some farmers' income increased because the farmers used flex acres to plant alternative crops in response to market signals. In fact, some farmers, particularly those who planted cotton on their corn or wheat base acres, expected to earn higher returns than they would have received by planting their base crops and collecting deficiency payments. Although farmers were free to leave

[3]A study mandated by the 1990 Farm Bill on how farmers used their flex acres was never undertaken. According to a USDA official, this study was one of over 40 mandated surveys that USDA, with congressional concurrence, did not conduct.

government programs and plant alternative crops before flex acres were established, the flex acres provision allows them to plant alternative crops while still retaining their base acres.

We were also told of other cases in which flex acres had resulted in income that was lower than if farmers had continued to receive deficiency payments. In these cases, the farmers had continued to plant their base crops even without the deficiency payments or they had idled their base acres. In Iowa, some corn producers continued to plant corn because they perceived that even without deficiency payments they could earn a higher return than they could earn on alternative crops. Also, some Texas rice producers did not believe that it would be profitable to grow rice without the deficiency payments, or they had no desirable alternative crops; therefore, the flex acres attributable to their rice base were left idle. While idling acres may reduce a farmer's short-run returns, in the long run, less intensive use of the soil resulting from idle acres may increase future crop yields and reduce the need for chemicals.

Farmers Use Flexibility to Meet Many Objectives

As table 1 shows, 8.1 million acres—or nearly 20 percent—of the available 41.8 million acres of normal and optional flex acres in 1992 were used for planting alternative crops. In general, according to USDA's data, there was an increase in soybean acreage and a decrease overall in program crop acres. (Upland cotton was the only program crop in which overall acres were increased.) The remaining flex acres were either used to plant the base crops or left idle.

Table 1: Distribution of Flex Acres in 1992

Acres in millions

Acres	Normal flex acres	Optional flex acres	Total flex acres
Used to plant alternative crops	6.9	1.2	8.1
Idled	4.5	None reported	4.5
Used to plant base crops	13.7	15.5	29.2
Total	25.1	16.7	41.8

Source: USDA's data.

In our discussions with USDA officials in 11 states, we found that the uses and applications of the flex acres varied by region and type of operation.

For example, we were told that some farmers believe that flex acres give them an opportunity to meet various objectives of their particular operations, while other farmers do not or cannot take advantage of the opportunity to plant alternative crops.

In addition, USDA officials told us that they use flex acres to help farmers maximize the benefits of the commodity support programs. According to these officials, flex acres make it easier for them to help farmers comply with the stringent requirements of income support programs. For example, without flex acres, a farmer who overplants a base crop would have to plow under the overplanted acres to participate in the annual commodity program. With flex acres, if that farmer has two base crops, the overplanted acres can be counted as the flex acres portion of the second crop, assuming that the second crop is underplanted by a like amount. Consequently, USDA would not require the farmer to plow under overplanted acres to remain enrolled in the commodity program.

Most of the USDA officials we interviewed in the 11 states told us that farmers like the flexibility they have gained from flex acres, although these officials said that farmers as a whole disliked the idea of losing deficiency payments. These officials also strongly indicated that flex acres have removed rigidities from USDA programs that require farmers to plant only their base crops. The anecdotal information we collected revealed that, for the most part, flexibility had improved farmers' ability to manage their operations and to meet other specific objectives, as follows:

- Increase returns. In eight states, we were told that some farmers used flex acres as a tool for increasing their returns. For example, some farmers shifted portions of their base acres from corn and wheat production, which they expected would provide their operations with relatively low returns, to cotton production, which they thought would provide a higher return. We were also told that in other states, farmers were able to make back at least a portion of the lost deficiency payments by planting alternative crops.
- Improve crop rotation practices. In seven states, we were told that farmers used flex acres to improve their rotation practices. A corn/soybean rotation is widely credited with improving soil conditions without the use of fertilizers. Rotation can also improve growing conditions for other crops. For example, some Virginia farmers who include peanuts in their crop mix used flex acres to rotate crops in order to produce higher peanut yields, and in Colorado, some farmers used flex acres to improve rotation practices and control weeds in wheat and barley fields.

- Adjust crop plantings in response to weather conditions. According to a USDA official in South Dakota, because of wet weather in early 1993, some farmers could not get all of their corn planted; therefore, they used flex acres to plant alternative crops such as soybeans, which do not need to be planted as early in the year. Also, a USDA official in Kansas indicated that in dry weather conditions, farmers in his state could use flex acres to switch from wheat to certain feed grains.
- Meet conservation compliance objectives. In four states, we were told that farmers used a crop that does not require the soil to be plowed, such as "no-till" wheat, as an alternative to the base crops that they generally plant in highly erodible areas.
- Increase farm efficiency. In six states, we were told that farmers used flex acres to consolidate some of their crop plantings in order to reduce the need to move equipment from field to field. In addition, flexibility has given farmers the opportunity to become better managers.

More Flexibility May Increase the Market Orientation of U.S. Farmers

Because normal flex acres—as well as optional flex acres used for alternative crops—are not eligible for deficiency payments, farmers are more apt to plant crops in response to the market than to grow crops in response to government programs as farmers have done in the past. Farmers now also have more incentive to change their crop mix to meet the objectives of their individual operations. Many of the USDA officials we spoke with said that farmers in their area would support additional flexibility if such action did not further reduce deficiency payments or farm income. Some officials also said that, while USDA informs farmers about various aspects of the commodity programs, not all farmers yet understand flex acres or how flexibility can be used. Therefore, it is possible that as the benefits of flex acres become better known, farmers will increase their use of flex acres to meet changing market demands or other needs of their particular operations.

While it is still too early to definitively measure the impact of flex acres on farmers' ability to respond to market opportunities, the limited use of the optional flex acres nevertheless provides an early indication of its potential. The use of optional flex acres is particularly significant because farmers voluntarily waive deficiency payments to grow alternative crops or idle the land. According to national statistics gathered by USDA for 1992, 1.2 million acres—or about 7 percent—of the optional flex acres were used to plant crops other than the base crops. However, the use of these acres varied by crop and state: While farmers in some states used a

relatively high percentage of their optional flex acres to plant alternative crops, farmers in other states used few optional flex acres.

There are a number of options for increasing the use of flex acres, all of which would require legislative change. Options include (1) increasing the number of normal flex acres ineligible for deficiency payments beyond the current 15-percent level, (2) increasing the number of optional flex acres, with corresponding decreases in deficiency payments, for those acres planted in alternative crops, or (3) permitting farmers to grow alternative crops on more than 25 percent of their base acres while continuing to receive deficiency payments on 75 percent of the acres. While the first option would clearly reduce government costs, the second and third options could also reduce these costs as farmers increase their use of optional flex acres. All three options would allow farmers to participate in USDA's commodity programs while continuing to increase their incentive to respond to the needs of the marketplace.

Conclusions

The flex acres established in the 1990 acts were designed to reduce the cost of government support for agriculture while increasing the international competitiveness of U.S. agriculture and the market responsiveness of individual farmers. Since there is only 1 complete year of experience with flex acres, no definitive assessment of the total impact of flex acres is possible. However, some observations can be made. According to USDA officials, decreasing the number of acres on which deficiency payments are made has reduced government costs and federal payments to farmers. Furthermore, although we cannot measure the impact on farm income with any assurance, the resulting flexibility has given at least some farmers the opportunity to increase their income by planting alternative crops. Others have been given the opportunity to partially offset the income loss due to reduced deficiency payments. Last, flex acres is the type of legislative reform that can help transition farmers away from reliance on costly government support programs. While farmers continue to receive some program benefits that provide them with a safety net, there is no longer such a strong incentive to exclusively plant base crops, and farmers can begin to become more aggressive in meeting the needs of a competitive global marketplace.

Matters for Congressional Consideration

While conclusive data on the full impact of flex acres on farmers' economic well-being are not available, flex acres have generally had a positive impact on farmers' operations and are projected to reduce federal spending. Because of the advantages of flex acres as a tool for reducing

the budgetary costs of farm programs and for transitioning farmers to a market orientation, the Congress should consider reauthorizing or expanding flex acres provisions in the 1995 farm bill.

Agency Comments

We discussed a draft of this report with USDA's Acting Director, Cotton, Grain, and Rice Price Support Division, Agricultural Stabilization and Conservation Service, and with other USDA officials responsible for administering the commodity programs. These officials agreed that it is too early to quantify the impact of flex acres on farmers and that our summarization of farmers' views appears reasonable. They also agreed that the matters for congressional consideration were appropriate.

Scope and Methodology

We interviewed USDA headquarters officials to obtain a comprehensive overview of flex acres. We also interviewed USDA officials (including district directors, county executive directors, and county committee members) in 11 states—Arkansas, California, Colorado, Iowa, Kansas, Mississippi, Ohio, North Dakota, South Dakota, Texas, and Virginia—to obtain an understanding of how and/or why farmers are using flex acres in various parts of the country. While the 11 states included in our review do not represent a random selection of states, they do represent geographically dispersed agricultural areas with different growing seasons and crop plantings. Collectively, the 11 states (1) accounted for over 50 percent of the base acres enrolled in USDA's commodity programs in 1992, (2) include the largest production of the program crops, and (3) represent different levels of response to the planting options for flex acres.

We obtained statistical data from USDA showing, by base crop, how the normal and optional flex acres had been used to date. We reviewed relevant literature and legislation and discussed using an economic model to evaluate the impact of the program with USDA economists as well as private and academic economists. On the basis of these interviews, we concluded that it was not feasible at this time to use an economic model to evaluate the impact of flex acres.

We conducted our review from April 1993 through November 1993 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days after the date of this letter. At that time, we will send copies to the appropriate House and Senate committees and subcommittees; interested Members of Congress; the Secretary of Agriculture; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who may be reached at (202) 512-5138 if you or your staff have any questions. Major contributors to this report are listed in appendix I.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

Jeffrey E. Heil, Assistant Director
Dennis J. Parker, Evaluator-in-Charge
Paul A. Dommel, Staff Evaluator

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