reduced by one-third in 1980 when payments to states were eliminated. SSI and the programs for veterans are the only programs included in this chapter that were exempt from major changes over the last two years.

The Current Situation

Although the Administration's 1983 budget included several proposed cuts, especially in the means-tested public assistance programs, few of these were implemented. A further reduction of about 5 percent was enacted in the Food Stamp program, and smaller reductions were made in veterans' programs, AFDC, and SSI. Outlays for this category as a whole in 1983 will depend largely on the state of the economy, and especially on the unemployment rate. If the unemployment rate in 1983 averages about 10.6 percent, as is now projected, total 1983 outlays for these programs will be about $98 billion.

Baseline Projections, 1984-1988

Total outlays for these programs are projected to grow very little in the 1984-1988 period. Outlays in 1984 will be about $6 billion lower than those for 1983, if unemployment falls as projected. Most of the decline in outlays will be accounted for by falling unemployment insurance payments. UI outlays are projected to continue to decline through 1988, although at a slower rate. Outlays for most of the other programs included in this chapter are projected to remain stable or to grow very slowly over the next five years, somewhat offsetting the projected decline in UI. Since in general the rate of growth is projected to be less than the rate of inflation, however, outlays in these programs will decline in real terms under current law.

DEFICIT REDUCTION STRATEGIES

This chapter examines several types of entitlement programs, concentrating on those that have not been heavily cut so far. Additional reductions in those that have already experienced large cuts might be difficult to achieve without major changes in the federal government's aims and responsibilities in these areas. Further, additional reductions in unemployment benefits and in assistance for low-income families and individuals might be undesirable in a period of high unemployment and economic recession, both because of their potentially adverse effects on the economy and because they might create substantial hardships for many individuals.

The specific changes discussed in this chapter have been organized into four major strategies, of which two would increase revenues and two would reduce outlays relative to current law. The revenue-increasing strategies are:

- o Provide additional revenues for programs financed through trust funds; and

- o Tax certain benefits for individuals.

The strategies that would reduce outlays are:

- o Increase the targeting of program aid on the neediest; and

- o Reduce inconsistencies among different programs that affect the same population.

STRATEGIES TO INCREASE REVENUES

This section examines the two strategies for increasing revenues. The various options considered under these strategies are summarized in Table V-2.

Provide Additional Revenues for Programs Financed Through Trust Funds

Several programs, including UI, Railroad Retirement, and Black Lung, are funded through trust funds, which, like the Social Security trust funds, have recently experienced some problems of solvency, largely resulting from the continuing economic recession. Employers' contributions for both the Black Lung and the Railroad Retirement programs were increased in 1981, and new limits were imposed on federal benefits under the Black Lung program. These changes were expected to maintain the solvency of these two funds over the long run, although continued declines in railroad employment could threaten the solvency of the Railroad Retirement System.

The unemployment trust fund faces more immediate problems of solvency. The UI system has been in financial trouble since the recession of 1973-1975. Since then, 30 states have borrowed from the federal government to pay benefits, and $10.6 billion was outstanding in loans at the end of calendar year 1982. The frequent and severe recessions of 1973-1975, 1980, and 1981-present have not allowed the system an opportunity to replenish reserves. The future financial picture for UI will depend largely on the extent of future unemployment.

TABLE V-2. REVENUE GAINS FROM REVENUE-INCREASING STRATEGIES IN OTHER ENTITLEMENT PROGRAMS (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Increases
Provide Additional Revenues for Programs Financed Through Trust Funds						
Index Tax Base for UI System	0.9	1.8	2.8	3.9	5.4	14.8
Tax Certain Benefits for Individuals						
Tax All of UI Benefits	a/	1.7	1.6	1.7	1.6	6.6
Tax 40 Percent of Railroad Retirement Benefits	0.5	0.7	0.8	0.8	0.8	3.6
Tax Veterans' Compensation Benefits	1.1	1.8	1.8	1.8	1.8	8.4
Tax Workers' Compensation Benefits	1.5	2.4	2.8	3.2	3.6	13.5

a. Less than $50 million.

To reduce federal outlays for the UI program would be difficult, because more than half of these outlays are actually expenditures by state UI programs, and states control the level of benefits in both the state and federal UI programs. (Both state expenditures and employer tax payments appear in the federal budget because they flow through the federal unemployment trust fund.) An alternative would be to increase UI revenues, which could be done by expanding the UI tax base.

Index the Tax Base for the Unemployment Insurance System. The tax base for the federal unemployment payroll tax is currently $7,000 per worker, having been increased only three times from its level of $3,000 in 1940. During that time, the proportion of wages subject to the federal tax has fallen from over 90 percent of total wages to less than 50 percent. The federal tax base also serves as the minimum base for state UI taxes. While the UI tax base has increased infrequently, UI benefits have tended to rise as wages rise: benefits are based in part on prior earnings, and many states index changes in their maximum weekly benefit to changes in the average weekly wage in the state.

The federal UI tax base could be tied to increases in average earnings in the economy, as is done with the Social Security tax base. This would generate about $900 million in additional revenues in 1984, and about $15 billion over the 1984-1988 period. This option would cause revenues to increase as benefits grow, and could help to stabilize the long-term financial situation of the UI system. On the other hand, increases in the UI payroll tax would increase the cost of employing workers, and could decrease the number of jobs available, at a time when unemployment is already very high.

Tax Certain Benefits for Individuals

Another strategy for increasing federal revenues and improving the targeting of program aid would be to subject benefits received by individuals to the federal income tax. This strategy was discussed in Chapter III with regard to Social Security benefits, and it could be applied to other programs such as Unemployment Insurance, Railroad Retirement, Veterans' Compensation, and workers' compensation. 4/ Since income tax rates rise with income, making these benefits subject to the federal income tax would be equivalent to a graduated reduction in benefits, focusing on those with higher incomes. If revenues from these taxes were allocated to the respective trust funds, this type of option could also be used to bolster trust fund balances.

Taxing these benefits would also reduce the existing differences in the tax treatment of benefit income and income from other sources. This principle could also be applied to other benefit payments to individuals,

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4. Unemployment Insurance benefits received by those with incomes over $18,000 per couple and $12,000 per single person are currently subject to tax. One-half of each dollar of income over these limits, up to the full amount of the UI benefit, is included in the recipient's adjusted gross income for the purposes of the federal income tax.

almost all of which are currently tax-free. Revenue gains from taxing benefits from means-tested programs would be small, however, since few people who qualify for means-tested programs would have enough income to incur any tax liability. Some examples of revenue gains that could be obtained from taxing entitlement benefits are shown below.

Tax All of Unemployment Insurance Benefits. Unemployment Insurance benefits generally are included in taxable income for individuals with incomes--including UI benefits--above $12,000, and for couples with incomes above $18,000. Recipients whose incomes only slightly exceed those thresholds have only a portion of their benefits added to taxable income, however, with the amount increasing with income. The taxable-income thresholds were lowered in 1982--they had been $20,000 and $25,000, respectively, since 1979. Including all of UI benefits in taxable income starting in 1985 would increase revenues by about $6.6 billion in 1984-1988.

Taxing all of UI benefits would result in additional tax liabilities for some UI beneficiaries, but the tax law itself exempts from tax incomes below certain levels--$7,400 for a family of four, for example. Proponents of this change maintain that it would result in more equal tax treatment of persons with similar incomes from different sources. This change would provide an added incentive for affected persons to seek reemployment, by reducing the value of their UI benefits compared with their after-tax income from earnings. If the change induced workers to find jobs more quickly, it would also reduce UI outlays by shortening the duration of UI payments. Since marginal tax rates below $12,000 and $18,000 are not high, however, this additional incentive might not be great.

Opponents argue that taxing the UI benefits of moderate and low-income persons would result in reduced incomes for those who can least afford it. In addition, because of the difficulty of finding employment in a period of high joblessness, taxation of benefits might have little effect in getting people back to work, in spite of any increase in work incentives.

Tax 40 Percent of Railroad Retirement Benefits. Taxing the portion of Railroad Retirement benefits that does not substitute for Social Security benefits and allocating the income received to the Railroad Retirement trust fund would be another way to decrease the projected federal contribution to benefit funding, and would reduce the existing anomalies between the tax treatment of such benefits and of private pensions. The revenue gain from this option would be about $500 million in 1984 and about $3.6 billion in 1984-1988.

The Railroad Retirement System (RRS) is an industrywide pension plan, which currently pays benefits to nearly one million annuitants and

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receives payments from about 400,000 railroad workers. Railroad Retirement predates and remains independent of the Social Security program, although the two systems now have many common features and coordinate their coverage. Unlike any other private pension, RRS is managed by the federal government, and the retirement income it provides is almost entirely tax-free. 5/

Since 1975, RRS has been structured to parallel the two-part retirement income available to employees in the rest of the private sector: a Tier I component that both substitutes for Social Security coverage and provides certain extra benefits, and a Tier II component that resembles an employer pension and may be supplemented by longevity payments. Both are financed through the Railroad Retirement trust fund, which, like the Social Security trust funds, receives contributions from both employers and employees. 6/ Because of the current recession, railroad employment has dropped precipitously, and the RRS faces financing problems in the near future.

If RRS benefits were treated in the same way as private-sector pensions, the portion that substitutes for Social Security would be tax-free, but both the "extra" benefits under Tier I and the Tier II employer pension component would be taxable to the extent that benefits exceeded employee contributions. Determining the appropriate tax under such a treatment would be administratively difficult, however. Approximately the same revenue increase could be achieved by taxing 40 percent of each RRS pension. If taxes are imposed on half of the Social Security benefits received by single persons with incomes over $20,000 and by couples with incomes over $25,000, as proposed by the National Commission on Social Security Reform, it might also be appropriate to tax more than 40 percent of the RRS benefits received by higher-income beneficiaries.

If benefits were made taxable, railroad annuitants would lose the substantial tax advantages they enjoy under current law. For example, a

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5. The only RRS benefits subject to federal income tax are supplemental longevity payments for retirees with the equivalent of 25 or more years of railroad service. These benefits began in 1966 and cannot exceed $840 a year. No taxes are collected, however, unless an RRS annuitant over age 65 has taxable income exceeding $4,300 if single and $7,400 if married and filing a joint return.

6. The Railroad Retirement trust fund also receives transfers from the Social Security funds to cover the costs of providing Social Security benefits for eligible railroad annuitants.

married annuitant under 65 with a pension of $21,000 a year--a typical level for a new retiree--now pays about $750 less in income taxes than retirees receiving the same income from a combination of Social Security and a private pension. 7/ Taxing Tier II benefits would reduce this tax advantage; nonetheless, RRS would still offer after-tax benefits comparing favorably with others in private industry. This option would have little or no effect on low-income annuitants because, even if RRS benefits were included in taxable income, such beneficiaries would still have incomes too low to make them liable for federal taxes.

Tax Veterans' Compensation Benefits. A third type of currently untaxed benefit is compensation for veterans with service-related disabilities, who are eligible for monthly cash benefits under the Veterans' Compensation program. Veterans' Compensation is the second largest non-means-tested program discussed in this chapter, and unlike UI it has not been significantly reduced in the recent past. Benefits are paid according to the degree of disability, and now range from $62 a month for 10 percent disability to $1,213 a month for complete disability, with payments of up to $1,350 a month in addition for veterans who require trained medical attendants, and up to a total of $2,111 a month for veterans who have suffered certain specific severe disabilities. Benefits are tax-free and paid without regard to income from other sources. If disability compensation was made taxable, the revenue gain would be $1.1 billion in 1984 and $8.4 billion in 1984-1988.

As with RRS benefits, taxing Veterans' Compensation benefits would have the advantage of targeting the reductions in after-tax income on those most able to afford them. Currently, Veterans' Compensation benefits are not reduced for veterans able to work or for those with other sources of income, and are thus not closely targeted to financial need. If benefits were made taxable, beneficiaries receiving additional income would pay higher taxes on their benefits than those relying on Veterans' Compensation alone. Like other proposals to tax benefits, this option would have the further advantage of treating incomes from different sources in the same way for tax purposes.

Any hardship resulting from taxation of benefits could be at least partially offset by increasing benefits 10 percent for beneficiaries who are 60 percent disabled or more--the group most likely to be in need because of earnings impairment. This group accounts for about 17 percent of the total number of beneficiaries, but receives about 60 percent of total benefits.

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7. When retirees and their spouses both reach age 65, this advantage declines to about $500, because of the extra $1,000 exemption available to all taxpayers over age 65.

Under this plan, however, the net budgetary gain would be reduced more than a fourth over the 1984-1988 period.

Those who oppose the taxation of Veterans' Compensation argue that disability compensation for those who suffered service-related injuries or illness should not be reduced because they have other sources of income, especially if the other sources are income from property or the labor of a spouse. In this view, veterans are owed their benefits in compensation for their service and the injuries they have suffered, without regard to their need.

Tax Workers' Compensation Benefits. A fourth type of benefit that is not currently taxed is workers' compensation. Most workers who suffer on-the-job injuries are insured by state-run, employer-financed workers' compensation programs. Workers' compensation payments cover medical expenses and some portion of income loss. If the payments for income loss were taxed beginning in 1984, federal revenues would increase by $13.5 billion over the 1984-1988 period.

The bulk of workers' compensation payments--about 70 percent--are made to compensate for income loss resulting from disability, rather than to cover medical costs. Assessment of a worker's degree of disability is necessarily inexact, and may or may not correspond to actual income loss. In addition, benefits vary considerably across states--the maximum compensation in cases of total disability ranges from $112 per week in Mississippi to $942 per week in Alaska, for example.

Taxing benefits provided to compensate for income loss would eliminate existing anomalies in treatment between beneficiaries and those who earn equal amounts in wages, but who must pay taxes. Further, in some cases benefits may exceed the lost wages net of tax, giving beneficiaries little incentive to return to work.

On the other hand, benefit levels differ significantly from state to state, and some hardships might result if low-benefit states did not increase their benefits to take account of the tax. In addition, because court-awarded damages for income loss due to non-workplace injuries are not subject to tax, it could be argued that it would be unfair to subject similar payments to tax in the case of workplace injuries.

STRATEGIES TO REDUCE OUTLAYS

This section examines several examples of the two strategies to reduce outlays in the other entitlements programs. These examples are summarized in Table V-3.

TABLE V-3. BUDGET SAVINGS FROM OUTLAY-REDUCING STRATEGIES IN OTHER ENTITLEMENT PROGRAMS (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Savings
Increase the Targeting of Aid on the Neediest						
Eliminate Veterans' Compensation Payments for Those with Low-Rated Disabilities						
Budget Authority	2.0	2.1	2.2	2.3	2.4	10.9
Outlays	1.8	2.1	2.2	2.3	2.3	10.7
Reduce the GSL Subsidy for Professional Students						
Budget Authority	a/	0.1	0.1	0.2	0.2	0.5
Outlays	a/	a/	0.1	0.2	0.2	0.5
Reduce Subsidy for Nonpoor Children in the Child Nutrition Programs						
Budget Authority	0.3	0.3	0.3	0.3	0.3	1.5
Outlays	0.3	0.3	0.3	0.3	0.3	1.5
Limit General Revenue Sharing to Fiscally Distressed Localities						
Budget Authority	1.4	1.5	1.6	1.7	1.7	7.9
Outlays	1.1	1.5	1.6	1.6	1.7	7.6
Reduce Inconsistencies Among Programs						
Reduce the Special Allowance to Lenders in the GSL Program						
Budget Authority	a/	a/	0.1	0.1	0.1	0.4
Outlays	a/	a/	0.1	0.1	0.1	0.3

a. Less than $50 million.

Increase the Targeting of Aid on the Neediest

In addition to taxing benefits, another way to target benefits more closely on those who are the neediest would be to narrow the focus of benefit awards in some programs. Although much has been done in this direction within the means-tested programs over the last two years, further steps could be taken to improve the targeting of aid in other programs like Guaranteed Student Loans, General Revenue Sharing, and Veterans' Compensation.

Eliminate Veterans' Compensation Payments for Those with Low-Rated Disabilities. An alternative method of improving the targeting of Veterans' Compensation benefits, other than subjecting them to the income tax, would be to eliminate cash payments to veterans with low-rated disabilities, while retaining their medical and health benefits. If cash benefits were eliminated for those with disability ratings of 30 percent or less, savings would be $1.8 billion in 1984 and $10.7 billion in 1984-1988.

Proponents of this cut argue that many veterans with low-rated disabilities do not suffer diminished work capabilities and, hence, should not be compensated. Elimination of these benefits would also result in more comparable treatment of disabled veterans and other recipients of disability benefits. On the other hand, many believe that compensation is owed to veterans for injuries and illness suffered while in service, without regard to their financial need.

Another way of targeting benefits for disabled veterans would be to eliminate dependents' allowances for those with disability ratings below 50 percent, which would save about $135 million in 1984. 8/ Like the previous approach, this might create additional work incentives for some disabled veterans who are in fact able to work. On the other hand, some veterans with disabilities in the 30 to 40 percent range may suffer substantial earnings impairment, and this option could create hardships for such veterans, especially if they have several dependents.

Reduce the GSL Subsidy for Professional Students. Obligations for the Guaranteed Student Loan program rose rapidly between 1978 and 1981--from $700 million to $2.8 billion--after the Congress made all borrowers,

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8. Before 1978, only veterans with disability ratings of 50 percent or more received such allowances, but under current law payments for dependents are received by veterans with disability ratings of 30 percent or higher, although payments are prorated according to the degree of impairment.

regardless of family income, eligible to have the interest on their loans paid by the government while they were in school. Under the 1981 Reconciliation Act, GSL borrowers remain eligible for the in-school interest subsidy, but loans are limited to families with incomes under $30,000 or with demonstrated financial need. The act also added a requirement that borrowers pay an origination fee equal to 5 percent of the amount borrowed. For all new GSL borrowers, the government currently pays 9 percent interest on their behalf while they are in school. It also pays the lender a variable amount, currently about 3 percent, during the life of the loan.

Even with the recently imposed income test, however, most graduate and professional students are likely to continue to qualify for GSLs. The GSL subsidy could be further targeted by eliminating the federal in-school interest subsidy for professional students, thereby reducing their long-term subsidy by about half. If students were allowed to borrow the interest while in school, this option would save about $500 million during the five-year period 1984-1988.

The argument for this change is that the entire current GSL subsidy may not be necessary for professional students, since they have better income prospects than other students, and most could be expected to pay the in-school interest in the form of higher repayments after graduation. On the other hand, under this option some lenders might drop out of the program because of its increased complexity, which would make GSLs harder for students to obtain.

Reduce the Subsidy for Nonpoor Children in the Child Nutrition Programs. The child nutrition programs, the largest of which is the National School Lunch program, provide cash and commodity assistance to schools and other institutions that serve meals to children. The programs reimburse these institutions for all qualifying meals served. The level of reimbursement in most of these programs depends on the income of the child's family.

In the National School Lunch program, for example, most schools receive $1.15 in cash reimbursement for each meal served to children from households with incomes below 130 percent of the poverty line, and lunches are served without charge to these children. For children from households with incomes between 130 percent and 185 percent of the poverty line, most schools receive a subsidy of 75 cents per lunch. Similarly, for children with household incomes above 185 percent of the poverty line, the subsidy is 11 cents per lunch. Comparable three-tiered reimbursement schedules are used in the School Breakfast program and in a portion of the Child Care Feeding program. Schools receive commodity assistance in addition to cash assistance for all meals served.

Eliminating the cash reimbursement for meals served to children from households with incomes over 185 percent of the poverty line--that is, with more than about $18,000 per year for a family of four in 1982, for example--would reduce federal expenditures by about $270 million in 1984, and about $1.5 billion over the 1984-1988 period. Savings would depend in part on the response of participating institutions to this change. Some schools, for example, might choose to drop out of the program if they judged that the federal reporting requirements and restrictions on meal composition were too burdensome to make continued participation worthwhile, or if too few children continued to participate in the program. The greater the number of schools that dropped out of the program, the greater would be the federal savings.

Proponents of this option argue that reimbursements for meals served to nonpoor children provide subsidies to households that are not in need of such assistance, and this change would therefore result in better targeting of nutrition assistance to those most in need. Opponents argue that meals qualifying for reimbursement under these federal programs are nutritionally superior to those from alternative sources, and eliminating subsidies for nonpoor students could result in lower quality meals. Further, a reduction in the subsidy might cause schools and other institutions to drop out of the program, thus denying poor children the benefits of free and reduced-price meals.

Limit General Revenue Sharing to Fiscally Distressed Localities. The General Revenue Sharing program provides unrestricted grants to general-purpose local governments--counties, cities, and townships. State governments were also entitled to funds until 1981, when they were eliminated on the ground that their fiscal condition no longer warranted federal subsidy. A similar approach could be applied to local government funding, eliminating the entitlement status of localities and providing funds only to jurisdictions with relatively low fiscal capacity or high tax efforts. If eligibility were limited in this way and funds were cut by 30 percent, federal savings would total about $1.1 billion in 1984 and $7.6 billion in 1984-1988.

Limiting funds to local governments most in need of federal aid would reduce the cost of GRS while maintaining support for governments experiencing the most fiscal stress. It would, however, further reduce aid to local governments at a time when cutbacks in other federal grant programs and the poor performance of the economy have left even relatively well-off jurisdictions in fiscal difficulty.

Reduce Inconsistencies Among Programs

Finally, a fourth strategy for reducing entitlement outlays would be to reduce inconsistencies among benefit programs. An example of such a strategy would be to reduce special allowances to lenders in the GSL program to levels more consistent with market rates of return for similar risk-free investments. The elimination of Trade Adjustment Assistance, which provides benefits to some, but not all, dislocated workers, would be a another example of this approach. It is not discussed here, however, because it would provide only small savings--less than $50 million in 1984, for example. If cost-of-living adjustments in the Social Security program are delayed six months as has been proposed by the National Commission on Social Security Reform, a similar delay in the cost-of-living adjustments for other indexed programs such as SSI, food stamps, and the veteran's programs could constitute a third example of this strategy. Such a delay would save about $800 million in 1984. 9/

Reduce the Special Allowance to Lenders in the GSL Program. This option would reduce yields for lenders providing student loans. Current yields may provide a larger return than necessary to induce lenders to participate--they receive 3.5 percentage points more than the bond-equivalency rate for 91-day Treasury bills, for example. On the other hand, substantial cuts in yields could drive lenders out of the program.

This potential problem could be avoided in two specific ways. Lenders' yields could be lowered in steps--with the lowest yield going to those with the largest volume, thus taking account of lenders' economies of scale. Alternatively, lenders' yields could be reduced while students are in school, since servicing costs are lowest during this period. Although savings would be small in the first few years under this option, each one-half percentage point reduction in the yield on new loans would reduce spending by about $300 million over the next five years.

CONCLUDING COMMENTS

Substantial reductions were enacted in most of the entitlement programs included in this chapter in 1980 and 1981, and further large savings would be difficult to achieve in many of them without major changes in program coverage and aims. This is especially true for the means-tested

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9. See Chapter III for further discussion. Savings estimate is preliminary and includes COLA delays in Veterans' Compensation, Railroad Retirement, SSI, Veterans' Pensions, and food stamps.

programs, as discussed above. Depending on the specific proposals, further reductions in other programs like Guaranteed Student Loans, General Revenue Sharing, and the child nutrition programs could also result in significant changes in their scope and purposes. This chapter does discuss some proposals for reducing outlays in these latter three programs, however, by improving the targeting of benefits and reducing lender allowances. Together, these strategies could save about $10 billion in 1984-1988.

Reductions in unemployment benefits in a period of high unemployment rates could also have substantial drawbacks, although the solvency of the Unemployment Insurance system is now under threat. High unemployment rates have reduced the reserves of the UI system, and 30 states have had to borrow from the federal government in order to pay benefits. Solvency could be restored by increasing the UI tax base, which has decreased in real terms as wages have grown. If the tax base were expanded each year in the same way as the Social Security tax base, $15 billion in additional revenues would be generated in 1984-1988.

This chapter also discusses some non-means-tested benefit programs that have not been reduced substantially in the recent past and that do not provide countercyclical benefits. These include Veterans' Compensation, the Railroad Retirement System, and some state-administered benefits like workers' compensation. Compensation for disabled veterans is relatively generous, especially for those with low levels of disability. If benefits for those with low levels of disability were eliminated, savings of over $10 billion would result over the 1984-1988 period.

Alternatively, revenues could be increased by subjecting benefits from Veterans' Compensation, Railroad Retirement, and state workers' compensation programs to the federal income tax. This would make their treatment more comparable to that of UI benefits, which are already taxed for recipients with incomes above certain limits. In addition, taxation of UI benefits could be extended to all recipients. Imposing the federal income tax on the first three types of benefits would generate revenue increases of more than $25 billion in 1984-1988. Including UI benefits in taxable income for all recipients would produce additional revenues of almost $7 billion over that period.

CHAPTER VI. AGRICULTURAL PRICE SUPPORT PROGRAMS

Outlays for agricultural price support programs rose sharply in 1982 to a record $11.6 billion, nearly three times more than outlays in 1981. This dramatic rise in spending reflected a sharp decline in farm prices resulting from large U.S. crops and weak export demand. For 1983, despite some program changes, outlays are projected to be $6 billion higher.

These expenditures are made through a number of agricultural commodity programs designed to support and stabilize farm prices and incomes. The programs use several tools, including commodity loans and purchases, direct payments, and supply controls. The principal commodities covered by these programs are wheat, corn and other feed grains, rice, upland cotton, tobacco, peanuts, milk, and wool. The focus of this chapter is on grains, upland cotton, and milk price support programs, which account for most price support outlays. The key elements of these programs are as follows:

- Grain and upland cotton prices are supported through nonrecourse loans. Farmers may put crops in storage and use them as collateral for government loans. The government agrees to accept a commodity as full satisfaction for repayment if the farmer elects not to repay in cash. A farmer may choose to repay the loan plus interest on or before its maturity date (usually nine months) and take over the storage and marketing.

- Wheat and feed grain farmers may also participate in the farmer-owned grain reserve. Under the reserve program, a farmer contracts to store grain for a three-year period in exchange for a government loan (at a loan rate higher than for nonrecourse loans) and annual storage payments. Grain in the reserve cannot be sold, except with a financial penalty, until the market price reaches the trigger release price at which time storage payments cease. If market prices are at or above the trigger release price, a farmer can repay the loan plus any interest or unearned storage payments. In the event that market prices never reach the trigger release price in the three-year period, a farmer would have essentially the same options as under nonrecourse loans.

- Grain and upland cotton farmers' incomes are supported through deficiency payments when national average market prices for a specified period fall below target prices. For example, the deficiency payment per bushel of wheat is the smaller of: (1) the difference between the national average market price for the first five months of the marketing year and the target price for wheat; or (2) the difference between the average market price and the nonrecourse loan for wheat. In 1982, the deficiency payment per bushel of wheat was $0.50, which was the difference between the nonrecourse loan rate of $3.55 per bushel and the target price of $4.05 per bushel--the average market price for the appropriate period being $3.34 per bushel.

- Grain and upland cotton farmers may be asked to reduce planted acreage from predetermined base levels to be eligible for the above program benefits. Further, they may be offered diversion payments for additional acreage reduction.

- Milk prices are supported through government purchases of surplus manufactured dairy products--cheese, butter, and nonfat dry milk.

Agricultural price support programs are entitlement programs that require the payment of benefits to any eligible individual. Most price support outlays are for price support loans and purchases, and direct payments to farmers. Federal spending for these programs is measured by net price support outlays, which are cash outlays minus cash receipts. Agricultural price support programs are financed through the Commodity Credit Corporation (CCC)--a government-owned corporation--which operates on borrowing authority from the Treasury as established by the Congress. The CCC receives an annual appropriation to reimburse it for unrecoverable losses incurred two years earlier.

BUDGET HISTORY AND PROJECTIONS

The Congress addressed the problem of rising price support outlays in the Omnibus Budget Reconciliation Act of 1982. This act authorized acreage-diversion payments for 1983 grain and cotton crops in order to increase prices and reduce outlays. It also provided for an assessment on milk sold by farmers intended to offset the costs of the dairy price support program. Because most of the budget effects of this retrenchment in federal support to crop farmers will not show up until 1984, however, outlays in 1983 are expected to continue increasing to $17.6 billion. Price support outlays for 1984-1986 are projected to average $7.0 billion.

Recent History, 1980-1982

Crop programs accounted for most of the increase in price support outlays in 1982 (see Table VI-1). The sharp run-up in crop outlays was caused mainly by record 1981 crops of wheat, feed grains, and upland cotton in the face of stagnant export markets resulting from poor economic conditions abroad and from the strength of the U.S. dollar. Crop prices fell by about 25 percent for corn and upland cotton, and 10 percent for wheat. As a result, farmers placed their crops under loan, particularly in the farmer-owned grain reserve, and received deficiency payments triggered by low prices. Of the $9 billion in crop outlays in fiscal year 1982, $7 billion was price support loans, $1.2 billion was deficiency payments, and $0.5 billion was reserve storage payments.

TABLE VI-1. FEDERAL OUTLAYS FOR AGRICULTURAL PRICE SUPPORT PROGRAMS (In billions of dollars)

Major Program	Actual 1980	Actual 1982	Estimated 1983	Baseline Projection 1984	Baseline Projection 1985	Baseline Projection 1986	Baseline Projection 1987	Baseline Projection 1988
Wheat	0.9	2.2	4.1	2.0	1.4	0.7	0.8	0.5
Feed Grains	1.3	6.4	6.1	3.1	2.6	1.5	1.3	1.1
Rice	-0.1	0.2	0.6	0.4	0.3	0.3	0.4	0.4
Upland Cotton	0.1	1.2	1.3	1.4	1.1	0.2	0.6	0.5
Tobacco	-0.1	0.1	0.1	0.1	a/	a/	a/	a/
Peanuts	a/	a/	a/	a/	a/	a/	a/	a/
Dairy	1.0	2.2	0.9	0.4	0.3	0.2	0.1	0.9
All Other	-0.4	0.3	4.5	1.6	1.7	1.6	1.5	1.5
Total	2.7	11.6	17.6	9.0	7.4	4.5	4.7	4.9

NOTE: Commodity program outlays shown in the above table are CBO baseline outlays. They are rounded to the nearest $100 million. A minus sign indicates a net receipt. This baseline does not reflect the implementation of the payments-in-kind program but does assume acreage control programs in effect during fiscal years 1984-1988 and assessments on milk marketings in fiscal years 1983-1987.

a. Indicates outlays less than $50 million.

Further increases in outlays are estimated for fiscal year 1983 because of a continued growth in supplies relative to demand. Large crop inventories were carried into the 1982 crop year. Then, despite acreage reduction programs, feed grain production reached a record high and wheat production fell only slightly from 1981. These large supplies combined with declining exports are causing crop prices to continue low. At the end of the 1982 crop year, grain stocks will be about one-half of total annual use, far in excess of adequate stock levels. Few of these stocks will be held free of government control--about two-thirds of them will be in the farmer-owned reserve and about one-fifth will be government-owned. Upland cotton stocks at the end of crop year 1982 will also be excessive: about 70 percent of annual use, despite a 23 percent drop in cotton production.

The run-up of price support outlays in 1982 and 1983 followed a long period, 1968-1981, in which highly volatile outlays averaged $3.2 billion a year. Government policy since the mid-1960s has been to reduce real (adjusted for inflation) levels of price support and make crop farmers more dependent on markets. This transition to less restrictive government policy, together with rapidly expanding agricultural exports (which grew at a rate of 19 percent per year from 1970 through 1980), resulted for a time in declining real price support outlays even though annual crop production rose. (Output in 1976-1980 averaged about 25 percent larger than in 1967-1972.) As demonstrated in 1982, however, price support outlays can increase substantially if large crops coincide with weak export markets.

In contrast to crop policy, dairy price support policy has changed little. High milk price supports in the late 1970s encouraged excessive milk production and caused dairy price support outlays to increase. These outlays, which averaged just 5 percent of total price support outlays in 1968-1979, rose to nearly half of total outlays in 1980 and 1981. From $1.0 billion in 1980, they rose to $1.9 billion in 1981 and $2.2 billion in 1982. In 1983, however, net outlays for the dairy price support program are estimated to fall to about $0.9 billion because of farmers' payments to the government to help defray part of the costs of the dairy price support program. The Department of Agriculture, however, has been temporarily restrained by the U.S. District Court for South Carolina from collecting the assessment.

The Current Situation

In 1982, the Congress sought to reduce price support outlays. Two principal actions were taken in the Reconciliation Act of 1982, and a third in the No Net Cost Tobacco Program Act of 1982:

- The Reconciliation Act mandated paid acreage diversion for the 1983 crops of wheat, feed grains, and rice as a means to reduce outlays and improve farm prices. The Secretary of Agriculture, under previously existing authority, also implemented a paid acreage diversion program for upland cotton.

- The Reconciliation Act authorized the Secretary of Agriculture to impose an assessment on dairy farmers of $0.50 to $1.00 per hundredweight of milk sold to offset a portion of the cost of the dairy price support program.

- The No Net Cost Tobacco Program Act of 1982 requires tobacco farmers to contribute to a fund as a condition for eligibility for price support. The fund will ensure that the government does not suffer any loss from the tobacco price support program.

To be eligible for benefits under the 1983 grain and upland cotton programs, farmers must reduce acreage from 1982 base levels. For wheat, rice, and feed grains the total acreage reduction is 20 percent (for wheat and rice that total reduction includes 5 percent paid diversion, and for grains, 10 percent). Cotton farmers must reduce acreage by 20 percent and may divert an additional 5 percent for payment.

An assessment on dairy farmers of $0.50 per hundredweight of milk was implemented on December 1, 1982. The Secretary has the authority to assess an additional $0.50 per hundredweight on April 1, 1983, if estimated annual government purchases are at least 7.5 billion pounds milk equivalent. Purchases are expected to exceed that level in the current marketing year. This second phase also provides for refunds to dairy farmers who reduce milk production. The Reconciliation Act of 1982 also fixed the minimum price support level for 1983 and 1984 at $13.10 per hundredweight, the same as in 1982--thus eliminating the mandatory increases required by the Food and Agriculture Act of 1981.

The No Net Cost Tobacco Program Act makes tobacco farmers bear any net losses, either of principal or interest, incurred by the government in supporting tobacco prices through nonrecourse loans. Net losses under the tobacco price support program account for less than 1 percent of total government losses for all price support programs during the past five decades.

In addition to these actions by the Congress, in January 1983 the Administration announced a payments-in-kind program for 1983 wheat, feed grains, rice, and upland cotton crops. This program provides for payments in commodities to farmers who divert 10 to 30 percent of their base acreages in addition to the acreage reduction programs already announced. Payments for this additional acreage will be 95 percent of farm program yields for wheat, and 85 percent of such yields for feed grains, cotton, and rice. As an alternative to diverting 10 to 30 percent of base acreages, farmers may bid to withdraw their entire base acreage from production.

Baseline Projections, 1984-1988

Agricultural price support outlays under current policies are projected to average $6.1 billion over fiscal years 1984-1988. For the five-year period, outlays for major crop programs average $3.9 billion annually with deficiency payments accounting for a large proportion of these outlays. Dairy price support outlays--under the assumption that assessment revenues are collected through fiscal year 1987--average $280 million each year over 1984-1987.

DEFICIT REDUCTION STRATEGIES

Record price support outlays are primarily the result of large U.S. crops in 1981 and 1982 and a weak world economy. Stagnant export markets have been caused by several factors: little or no economic growth in many countries, financial instability in a number of countries, a strong U.S. dollar, continued East-West political tensions, and highly subsidized agricultural exports by other countries, mainly the European Community. Further, there is a growing protectionist sentiment worldwide as nations look for ways to protect their recession-plagued industries from imports. The strength of the U.S. dollar has resulted from the flow of foreign investment into the United States attracted by high interest rates. Therefore, even though the prices received by U.S. crop farmers have fallen over the past two years, importers in many foreign countries have not benefited proportionately because of the appreciation of the dollar, which in some cases has increased prices to importers.

Clearly, these international factors have a negative impact on U.S. crop farmers. For many of them, 1983 is expected to be the fourth consecutive poor income year as production expenses continue to rise but cash receipts remain stagnant. Furthermore, this bleak outlook, despite record price support outlays, demonstrates the problems in using such programs to offset the adverse consequences of large crops and of international events.

In an environment dominated by international economic conditions, the options for reducing crop price support outlays are limited. Since the