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Whole-Farm Approaches to a Safety Net

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Abstract

In recent farm policy debates, proposals for a whole-farm revenue safety net program have been put forward that could provide a farm-income safety net for a wide variety of farming activities. These proposals include income-stabilization accounts and whole-farm revenue insurance. Risk protection from income-stabilization accounts would depend on the reserves in individual accounts and the structure of program benefits. Experience with farm savings accounts in Canada and Australia suggests that lack of adequate account balances and buildup of balances beyond the level required for risk management can reduce program effectiveness. Whole-farm revenue insurance could overcome these problems since coverage would not depend on the farmer's ability to build an account balance and benefits would only be realized when the farmer suffers a drop in income. However, the complexity of factors affecting income variability raises questions about the feasibility of a whole-farm insurance plan.

Keywords: safety net, income variability, risk management, income-stabilization accounts, savings, tax, revenue insurance

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Summary

Providing a “safety net” for farmers is an often-cited objective of U.S. farm policy. Safety nets are policies intended to ensure a minimum level of economic well-being for a group of people or to provide protection against risks. Current U.S. farm programs form a safety net of coverage and support to U.S. farmers through direct and countercyclical payments, crop insurance, emergency and other loans, and disaster assistance.

Many farms and farm households are not directly covered by the current safety net. Commodity programs that provide direct income support reach only one in four U.S. farms. Although the Federal crop insurance program covers most of the acreage of major field crops, relatively few U.S. farms purchase such insurance. There is no broad program of income support or insurance for livestock. As a result, the safety net may reduce risk for some, but not all, farmers.

What Is the Issue?

In recent U.S. farm policy debates, several “whole-farm revenue” programs have been proposed as a new form of safety net that would be available to all U.S. farms. A whole-farm program is based on revenues from all farming activities added together and is not linked to the production of particular commodities. This report looks at the risk management potential for such programs and the obstacles to implementing such a whole-farm revenue approach to a farm safety net.

What Did the Study Find?

Two prominent whole-farm programs—*income-stabilization* (savings) accounts and *revenue insurance*—have the potential to overcome the disadvantages of current farm-safety-net programs because they could be applied to a wide variety of farming situations and would not be linked to the production of particular farm commodities. *Income-stabilization accounts* encourage farmers to manage risk by making deposits to special savings accounts in high-income years and making withdrawals, when needed, in low-income years. The government would provide incentives, such as tax deferrals and matching contributions. Risk protection from income-stabilization accounts would depend on the reserves in individual accounts, and those amounts could vary with farmers’ levels of participation and distribution or concentration of program benefits.

While farm income-stabilization accounts could potentially extend the safety net to more farms than current programs, proposals that require a positive net farm income or a minimum level of farm business receipts would greatly restrict eligibility for many farmers. In addition, many eligible farmers would not have the cashflow capacity to fully fund their accounts after considering living expenses, taxes, and debt service requirements. In some instances these farmers could shift existing assets to capture tax or other benefits. However, since this would not increase overall savings, it would not add to their risk management capabilities.

Analyses of three income-stabilization account proposals suggest that a large share of income-stabilization account deposits could be concentrated among large farms, providing a distribution of benefits similar to current crop insurance and farm program payments. Thus, for many, income-stabilization accounts may not provide sufficient protection, especially in the early years of a program or when successive disasters deplete farmers' funds. At the same time, depending upon the structure of the program, some farmers might build subsidized balances beyond the levels necessary to satisfy risk management goals. Experience with farm savings accounts in Canada and Australia has confirmed that both the lack of adequate account balances and the buildup of balances beyond the level required for risk management purposes can reduce the overall effectiveness of income-stabilization programs.

Whole-farm revenue insurance has the potential to overcome those obstacles because coverage does not depend on the farmer's ability to build a balance but instead is purchased with a premium. Additionally, balances do not accumulate since there is no access to the risk management pool unless the producer experiences the required loss or drop in income. Whole-farm revenue insurance is currently available under the Federal crop insurance program through two pilot programs, but questions remain about the feasibility of making those programs the main U.S. farm safety net. One key concern is the complexity of the factors that determine farm income and how those factors vary from farm to farm and from year to year.

How Was the Study Conducted?

ERS researchers used special tabulations of Internal Revenue Service data to analyze the income-stabilization potential of three prominent farm income-stabilization account proposals. With those data and farm-management records from various State recordkeeping associations, the authors examined farm-level variability of income and issues that could arise in the development of whole-farm income approaches to an economic safety net for farmers.