Introduction

One of the main objectives of U.S. farm policy is the provision of a "safety net" for farmers. In the most general sense of the term, safety nets are policies that:

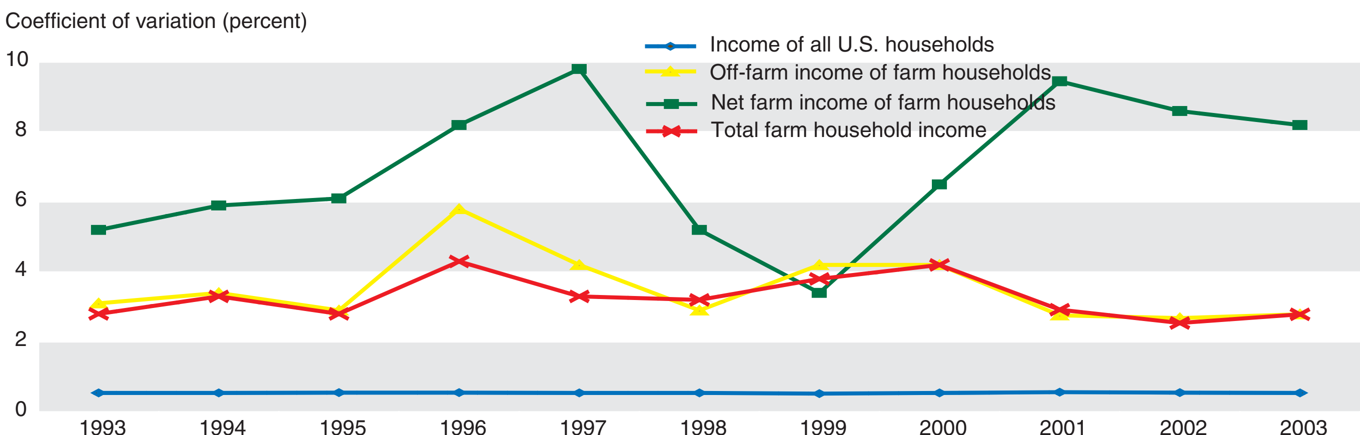
- aim to ensure a minimum level of economic well-being for a group of people or
- provide protection against risks (Gundersen et al.).

Current farm policies, which are often commodity based, form a web of coverage and support through programs such as direct payments, nonrecourse loans, countercyclical payments, crop insurance, emergency loans, and disaster assistance.

Commodity-based programs tend to direct benefits to certain segments of the farm sector. While program commodities account for a large share of U.S. farm output, many farms and farm households are not directly covered by the current safety net. For instance, commodity programs that provide direct income support reach only one in four U.S. farms (Dimitri, Effland, and Conklin). The Federal crop insurance program, which offers subsidized coverage on a crop-by-crop basis, has seen participation reach 75 percent to 80 percent of major field crop acres, but relatively few farms purchase crop insurance (Dismukes and Glauber). Moreover, although pilot programs have been initiated for several livestock enterprises, there is no general program of income support or insurance for livestock. As a result, the safety net may reduce risk for some farmers (Babcock and Hart, 2004), but not all.

One purpose of providing a safety net for farmers is to reduce year-to-year variability in farm income. Because of vagaries of weather, shifts in market conditions, and other events beyond a farmer's control, agricultural commodity production and prices can vary unexpectedly. The resulting

Figure 1
Income of farm operator households is more variable than income of all U.S. households



Note: Coefficient of variation is defined as the ratio of standard deviation of income to the mean of income from year to year.

Source: USDA. Economic Research Service,1993-2003 Agricultural Resource Management Survey; U.S. Census Bureau, Current Population Survey for all U.S. households.

changes cause instability in farm household income (Mishra, El-Osta, and Morehart) and are the main reason that farm household incomes tend to be more variable than the income of all U.S. households (Mishra and Sandretto).

Farm income variability affects the economic well-being of farmers because it can threaten the viability of the farm business and can hamper the farm household's ability to maintain consumption and build reserves for future needs. Farmers use a variety of methods to reduce or manage income variability (Harwood et al.). Strategies such as purchasing crop yield and revenue insurance, forward contracting, hedging, and participating in commodity loan programs reduce the chances that a farm's revenue will drop below a certain proportion of its expected level during a growing season. Management decisions such as renting land or custom-hiring field operations instead of borrowing to purchase land and equipment can reduce a farmer's risk exposure. During years with low net income, farmers also commonly delay the purchase of new capital equipment.

Off-farm income often provides a supplement to farm income and allows many U.S. farm households to maintain consumption when farm income is low. In fact, most farm households receive more than half of their income from off-farm sources. Even farm operator households associated with commercial farms ($250,000 or more in annual farm sales) receive about 25 percent of their income from off-farm sources (Jones et al.).

In addition to having other sources of income, many farm households have assets that may provide a buffer against occasional drops in farm income. Drawing on assets to offset declines in farm income may be problematic, however. About 70 percent of the assets of the average farm household are farm-related assets. For commercial farm households, the share of assets that is farm-related is nearly 85 percent. The largest asset of farm households is farmland, which accounts for about three-fourths of their farm assets. The value of farm-related assets, particularly farmland, tends to fluctuate with income. In addition, other farm assets, such as equipment, are not easily transferred to other uses (www.ers.usda.gov/Briefing/ARMS).

Another reason for considering whole-farm approaches to a farm safety net relates to trade issues. Programs providing protection based on current or historical production of covered commodities are problematic under international trade policy rules. They have been criticized as distorting farmers' production decisions by interfering with market signals, providing incentives to produce these commodities even when market prices indicate that production would not be profitable. Such programs can lead to excess production, which would depress prices.