

Farmer Savings Accounts

Mark A. Edelman, Iowa State University

James D. Monke, Economic Research Service, USDA

Ron Durst, Economic Research Service, USDA

Introduction

Various incentives can be used to encourage farmers to save for bad times. In Canada, for example, the government matches farmer deposits and provides interest rate bonuses. In Australia, a relatively new program allows farmers to defer taxes on savings deposits in good years so they can be withdrawn at lower tax rates in poor years. Although the concept has been debated in Congress since 1996, the United States has not yet implemented a specific farmer savings account program. However, such a proposal may emerge in the 2002 Farm Bill debate, or as part of a broader tax package developed by Congress and the Administration.

World trade agreements increasingly discourage trade distorting farm policy payments linked to commodity specific prices and production. Farmer savings account incentives represent one approach to potentially meet the emerging criteria.

Policy Alternatives and Consequences

Six policy alternatives are outlined in this paper to provide some understanding of the role farmer savings incentives might play in future farm policy. A more detailed comparison of the first four options discussed is included in Table 1. The last two choices discussed include making no change in current policy, and creating a new choice from a combination of options.

Option 1: Canadian-styled Net Income Savings Accounts (NISA)

Canada implemented a NISA program in 1991. Under the program, a farmer who makes a deposit into a NISA account receives a government matching deposit up to 3 percent of Eligible Net Sales (ENS) — defined as gross sales of qualifying commodities less purchases of seed, plants, and livestock. The Canadian government also pays a 3 percent interest rate bonus over local bank rates on all farmer deposits.

Table 1. A Comparison of Policy Attributes for NISA, FARRM, IRMA , and FPPR Programs.

Policy Attributes	NISA	FARRM	IRMA	FPPR
Farmer Deposit Maximums/Minimums	Maximum 20% ENS Eligible Net Sales/yr	Maximum of 20% "Eligible Net Farm Income"	Minimum of 2% Gross Farm Income (Schedule F)	None specified
Maximum Account Balance	150% up to 5 year average Eligible Net Sales	None	150% of 3 year average Gross Farm Income (Schedule F)	150% of 5 year avg. Gross Farm Income (Schedule F)
Farmer Deposits Pretax/After Tax?	After Tax Income	Pretax Income	Pretax Income	Not specified
Government Deposit Subsidy	Match \$ for \$ up to 3% ENS (\$7,500/yr Max.)	None	2% Gr. Income Subsidy & CAT coverage	Program Payments Deposited Pretax
Interest Rate Bonus paid by Government	Additional 3% on farmer deposits	None	None	None specified
Farmer Deposit Taxable?	Taxes paid before deposit	Tax Deferred until Withdrawal	Tax Deferred until Withdrawal	None specified
Government Deposit Taxable?	Tax Deferred until Withdrawal	Not applicable	Tax Deferred until Withdrawal	Tax Deferred until Withdrawal
Interest Earnings Taxable?	Tax Deferred until Withdrawal	Annually	Tax Deferred until Withdrawal	Tax Deferred until Withdrawal
Withdrawal Triggers and Time Limits?	Gross Margin less than 5 yr average; or Net Income below \$20,000 for individual or \$35,000 for family	Full Farmer Discretion; Rolling 5 year time limit on each year's deposits	Current year Gross Income less than 80% of 3 year average	Current year Gross Income less than 5 year average
Advanced Withdrawals	Yes	Not applicable	None described	None described
Use of withdrawals for Farmer Deposits	Yes	Yes, at Farmer Discretion	No limits described	None described
Limits on Insurance Coverage	None	None	Farmer may only buy insurance not subsidized	None
Unused Match Carried Forward	Carried forward up to 5 years	Not Applicable	None Described	Not specified
Voluntary Close Out Options	Yes, lump sum or 5 year installments	Yes, if less than 5 years	None described	None described
Mandatory Close Out Criteria	Failure to apply for 3 years; failure to apply after advance payment; fail to meet repayment deadline for overpayment	Failure to farm 2 years consecutive. 10% penalty if each year's deposits not withdrawn in 5 years	Leave farming for non-farm employment; retirement; or bankruptcy	Leave farming for non-farm employment; retirement; or bankruptcy
Differential Tax Rate Bias for High Income Farmers	Not on farmer deposits, but deferral benefit may be greater on government match and interest payments	Yes, greater incentive to save for higher tax rates	Yes, greater incentive to save for higher tax rates	Not specified
Relative Budget Exposure Among Four Options	High	Low	Medium	Depends on scope and interpretation
Relative Farmer Participation Rates Among Four Options	High	Low	Medium	Mandatory

NISA has two rules for triggering withdrawals. Withdrawals can be made under an “Income Stabilization” trigger when the farmer’s current year “Gross Margin” falls below the farmer’s average for up to five previous years. Gross margin equals net sales from all agricultural commodities, plus income from contract work and machine rental, minus eligible expenses. Gross margin is roughly analogous to Schedule F Gross Farm Income.

Alternatively, withdrawals can be made under a “Minimum Income” trigger when the farmer’s current net income from all sources falls below a threshold level plus a matchable deposit. The current minimum income trigger is C\$20,000 per individual or C\$35,000 per family.

Participation in NISA is voluntary. Farmers may voluntarily leave and rejoin under specific rules. Farmers are required to opt out if they quit farming or retire.

NISA Account Probable Consequences

- **Nearly all farm enterprises are eligible.** Canadian incentives induce slightly more than half of Canada’s farmers to participate in NISA.
- **Income stabilization capability grows over time.** For those with NISA accounts, the 1999 average balance per farm was C\$16,000. Since NISA withdrawals are counter-cyclical in nature (can only be made in poor years), farmer payments in good years are less likely to cause public concern.
- **NISA payments are decoupled for planting flexibility.** Matching payments to farmers are based on self-help and whole farm gross income. Therefore, NISA payments are decoupled from commodity specific production, prices, and planting decisions.
- **Government spending can become more stable and predictable.** Because spending for matching deposits is spread out over several years, government spending on NISA is less variable from year to year compared to most “pay as you go” counter-cyclical programs.
- **Other income support programs are still needed.** Subsidized crop insurance and government funded NISA incentives are farm

program mainstays in Canada. Canada continues to maintain an ongoing supplemental disaster assistance program.

Option 2: Farm and Ranch Risk Management (FARRM) Accounts

U.S. proposals for FARRM savings accounts originally surfaced during the 1996 Farm Bill debate, and again reappeared in 1998, 1999 and 2000. Under the FARRM concept, deferred taxes provide the incentive for farmer savings.

Farmers take a federal income tax deduction for FARRM account deposits. In the most recent proposal, farmers would be eligible to deposit up to 20 percent of “eligible net farm income,” which is taxable net farm income plus capital gains from the farm business, excluding land. Deposits would be held in interest-bearing accounts at approved financial institutions. Interest earnings are distributed to the farmer and are annually taxable in the year earned.

Withdrawals from FARRM accounts are made at the farmer’s discretion and are taxable in the year withdrawn. Unlike the NISA program, there are no price or income triggers. FARRM deposits could stay in an account for up to five years, with new amounts added on a first-in, first-out basis. FARRM deposits not withdrawn in 5 years would incur a 10 percent penalty.

FARRM Probable Consequences

- **Maximum farmer flexibility, but no assurance savings used as safety net.** Farmers are free to make withdrawals whenever they choose. Taxpayers have no assurances that farmer withdrawals will actually be used as the farmer’s safety net during bad years.
- **Farmers in high tax brackets receive greater incentives.** Because FARRM uses tax deferral incentives, high tax bracket farmers receive greater benefits and incentives to save. The most recent proposal does not limit annual contributions or account balances.
- **Benefits go to relatively few farmers.** Deposits based on net income are more limiting than gross income. Over two-thirds of sole

proprietors either report a farm loss or have no federal income tax liability, and could neither participate nor benefit from FARRM accounts.

- **Agricultural cycles are often longer than five years.** While government tax deferral costs on FARRM accounts become more stable after the first five years during which primary account balances are established, livestock and weather cycles often last longer.

Option 3: Individual Risk Management Accounts (IRMA)

The IRMA concept originated from an Alabama Farmers Federation study committee. IRMA accounts are voluntary and contain a combination of deferred tax and government matching deposit incentives. Similar to FARRM accounts, IRMA deposits are deductible from pretax income. Deposits and interest are taxable after withdrawal.

A farmer who wishes to participate deposits a minimum of 2 percent of Schedule F gross farm income each year into an IRMA account. The federal government matches the farmer's 2 percent deposit with another 2 percent deposit, using dollars that would have been used to subsidize the farmer's crop insurance. IRMA farmers receive CAT coverage, but additional crop insurance purchased must be non-subsidized.

Also similar to NISA, farmers can maintain maximum IRMA balances of no more than 150 percent of the farmer's three-year average Schedule F Gross Farm Income. The IRMA plan contains a specific withdrawal trigger that only allows farmers to make withdrawals if their current year Schedule F Gross Income Falls below 80 percent of the average for the previous three years. The withdrawal can only bring the income up to the 80 percent level.

IRMA Probable Consequences

- **Based on the magnitude of the IRMA incentives to save,** farmer participation rates and safety net accumulation rates are likely to be greater than under FARRM accounts but less than under the NISA program. Similar to FARRM, IRMA provides greater savings

incentives in the form of tax deferral for farmers in higher tax brackets.

- **Minimum contribution requirements may cause cash flow problems.** The annual minimum matchable deposit requirements may cause cash flow problems for some farmers, particularly those previously not purchasing crop insurance.
- **IRMA may shift farm level risk.** Encouraging farmers to substitute IRMA for subsidized crop insurance could expose farmers to increased risk, particularly if the farmer's accumulated balances are not sufficient to cover a financial loss.
- **IRMA could impact government insurance costs.** Government costs for subsidized insurance may rise as low risk farmers exit crop insurance programs in favor of IRMA.

Option 4: Farm Program Payment Reserve (FPPR) Accounts

AMTA payments (or other program payments) could be linked and diverted to farmer savings accounts to build safety net reserves for individual farmers. If AMTA payments are diverted to FPPR accounts in good years, they are available for use in bad times. If such FPPR accounts had been in effect with the passage of the 1996 Act, government payments in high-income years would have accumulated so that each farmer receiving AMTA payments would have had a safety net of reserve balances during the lower income years that followed.

For illustrative purposes, suppose a new FPPR proposal emerges during the 2002 debate over AMTA payments and specifies that 50 percent of future AMTA payments (and/or other designated farm program payments) be deposited by the Farm Service Agency into a FPPR account in the farmer's name. In effect, such a proposal would convert part of the fixed AMTA payments into a counter-cyclical payment program.

Similar to NISA, FPPR balances could be capped at 150 percent of the farmer's five-year average Schedule F gross farm income. Farm program payments would revert directly to the farmer when the FPPR account maximum is reached. Withdrawals could be triggered when current year

gross farm income (Schedule F) falls below the farmer's average for the previous five years. A farmer would be eligible to withdraw up to the difference between the current year's gross farm income and the five-year average.

FPPR Account Probable Consequences.

- **Potentially opens risk management to all farming activities reported on Schedule F.** If Congress designates livestock and specialty crops producers to receive government deposits, they, too, would benefit from FPPR accounts in low-income years. However, if deposits are restricted only to AMTA payment recipients, the benefits would be restricted only to farmers producing program crops under AMTA.
- **No new funding is required if FPPR deposits come from existing outlays.** Government costs for FPPR accounts would be relatively stable if a portion of existing outlays for updated AMTA payments are used for FPPR deposits.
- **Farm program benefits are less likely to inflate land prices in good years.** The part of the farm program payment diverted to a FPPR is no longer available to bid up land prices during good years. Instead, this portion of a farmer's program payment goes to building individual farm safety net balances that are then available in poor income years.
- **Taxpayers are assured that FPPR accounts provide safety net in bad years.** Unlike FARRM accounts, FPPR accounts have withdrawal triggers to assure taxpayers that deposits are withdrawn by farmers in low-income years. Unlike voluntary savings programs, FPPR accounts assure taxpayers that all farmers receiving designated farm program payments will have some reserves. As farmer FPPR participation increases, safety net reserves grow to reach effective levels and dependence on ad hoc disaster programs declines.

Additional Policy Options

Two additional public policy options are worth mentioning: a combination of options and continuing the status quo policy. If Congress and the Administration adopt enhanced incentives for farmers to save for bad times, the final policy adopted may very well represent a compromise or hybrid of some of the options previously discussed and any new proposals that develop.

Such a compromise would largely depend upon the answer to a key policy question regarding the goals of farmer savings accounts. Should they be designed to make AMTA payments more counter-cyclical, as a supplemental risk management tool, as a substitute for subsidized crop insurance, or as a mechanism for building safety net balances to reduce the need for future ad hoc disaster programs?

Alternatively, the Congress and the Administration may choose to continue the status quo policy of not providing enhanced incentives for farmers to save beyond those already provided. Some interests may argue that additional incentives for farmers to save are not needed because, in their view, farmers already have several private sector tools and several public sector programs available to help them manage risks and weather the impacts from disasters. Thus, a decision of no change often represents the easiest choice for the policy arena to make and implement.

Implications and Tradeoffs for Farm Bill Stakeholders

Savings incentives can help farmers to manage risks and create a self-help safety net for each farmer, to the degree that the farmer's net savings increase, assets accumulate and the farmer's

investment portfolio becomes more diversified. Added savings also represent a form of self-insurance that builds assets in contrast to adding insurance premium expense. However, the level of risk exposure depends on the farmer's previous accumulation of account balances on reserve.

Taxpayers are interested in the concepts because farmers may come to rely more on their own safety nets, and reduce reliance on ad hoc government disaster programs or subsidized crop insurance. Having greater deposits in rural financial institutions potentially results in two benefits for rural communities. Farm family consumption expenditures likely become more stable in periods of highly variable economic conditions. Second, as rural deposits increase, rural financial institutions potentially facilitate a greater level of rural lending.

References and Suggested Readings

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