

The Risks of “One Size Fits All” Farm Policy



**The Council on Food, Agricultural
and Resource Economics**
An Organization of Agricultural Economists

The Lay of the Land: Contextual Considerations in Farm Policy

Every good farmer knows the lay of his or her land—the dry patches as well as the bogs, the places that need a little more fertilizer, the spots prone to erosion. Indeed, without such knowledge, farming would be a hit or miss operation. And just as successful farming requires a deep understanding of its environment, so too does successful farm policy. Policymakers, like the farmers they seek to serve, need to know the context in which their actions are played out—a context that, with its many variations, determines the success or failure of those actions. Differences in the land require different farm practices. Differences in the farm sector require different policy approaches. One size—whether in farming, or in farm policy—does not fit all.

Economics can help.

While economics cannot answer every question that must be addressed in the policy process, it can help with many. The answer to “*Who should benefit from farm programs?*” is subjective, depending on values. The answers, however, to “*Who does or will benefit?*”, “*Why?*”, and “*How?*” are right up the economists’ alley. And those answers are critical in helping policymakers see to it that whoever *should* benefit, *does* benefit.

Focus on the horizontal.

To help policymakers better understand the lay of the land, this report summarizes recent findings in four key agricultural issues: size, land tenure, risk, and rural development. This *horizontal* examination of the agricultural policy context will be supplemented by a future, vertical, look at food system issues—things like farm contracting, supply chain management, and integrated operations.



Key Contextual Considerations

Size Matters.

According to USDA’s Economic Research Service (ERS), there are approximately 2.1 million family farms in this country. Not surprisingly, those farms vary widely on several important, and policy-relevant, characteristics. To help understand those differences, ERS created a farm typology based on the occupation of the operator and the amount of annual sales.

Applying the typology helps clarify the context for developing and evaluating farm policy. The resulting picture is one of great differences for small versus large farms.

- **Small farms outnumber, but large farms outproduce.**

Nine out of ten of this country’s farms are small (sales less than \$250,000), and small farms account for nearly 7 out of ten acres of farmland. Yet small farms produce less than one-third of total agricultural output; large and very large family farms and nonfamily farms produce two-thirds.

Why? Two reasons. First, the average cost¹ of production decreases as the size of farm increases (what economists call “economies of size and scale”), because large farmers are better able than small farmers to use machinery sizes that are more efficient and to shop around for inputs—for example, using the Internet to find suppliers—and realize significant discounts on input prices.

Second, productivity (or yield) increases as the size of farm increases because larger farms have the equipment to allow them to plant and harvest quickly, as well as the knowledge and management skills necessary to select appropriate technologies, use the most efficient input mix, and properly time operations.

- **Large farms generate profits, small ones don’t.** On average, the total cost³ of operating a small farm

exceeds the income it produces. Only large and very large family farms and nonfamily farms, on average, generate profits.

Why? In addition to lower costs of production and higher productivity (which increase profitability), large farms get higher prices for their products primarily because of

their ability to pursue more effective marketing and commodity program management strategies. Such strategies might include forward contracting, options, government insurance programs, and timing of Loan Deficiency Payments (LDPs). Small farms rely greatly on nonfarm income and seem willing to adopt lower returns to their capital, labor, and management.

- **Government payments help small farms.** While nearly half of all government payments go to high-sales small farms and large family farms—farms that tend to specialize in cash grains, which are covered by the commodity programs—the small proportion of government payments that goes to limited resource farms help keep them afloat.

Small Family Farms (sales less than \$250,000)

- limited resource
- retirement
- residential/lifestyle
- farming-occupation/low-sales
- farming-occupation/high-sales

Other Family Farms

- large family farms
- very large family farms

Nonfamily farms





• **Off-farm jobs also help.**

Small-farm households rely heavily on off-farm income, which helps keep them afloat even when they incur losses from farming. Indeed, fewer than one in four farm families get the majority of their income from farming, and nationwide, only 15 percent of the total income earned by farm households comes from farming.

Clearly, when it comes to farming, size matters. While small farms are by far the most numerous and work the majority of our farmland, they are neither the most productive, nor the most prosperous. Indeed, were it not for government payments and off-farm income, many small farms might go under.



Another way of looking at it: unless farmers own the land, they are not realizing most of the program benefits. In the case of cash rent leases, program benefits are often bid into local cash rental rates quite quickly. In either rental situation, program benefits are ultimately capitalized into land values.

It's a Risky Business.

Agriculture faces many risks—from changes in global production to changes in economic conditions to changes in weather. Who

bears those risks, how they are managed, and how our public policies help or hurt, are important considerations.

• **Various parties bear risk.**

In farming, legal risks are borne first by landowners through their claims on leases to farmers, second by lenders through their loans, and finally owners bear the residual risks⁴ through their equity capital⁵.

• **Different ways of managing risk.**

Managing risks, that is, finding an appropriate balance between risk and return, takes many forms. Production options are those things that farmers do in the planting, growing, and harvesting of their crops to manage risk—things such as enterprise, geographic, seed, and timing diversity; pesticide use; irrigation and drainage; and precision agriculture. Marketing options—forward contracts, hedging and options, cooperative pooling, and the like—come in at the selling stage. Financial options, of course, involve money—the timing of capital expenditures, tax management, debt/asset adjustments, etc. Finally, strategic options—planning, relationship building, managerial backup, and governmental

relations—
complement and/or guide all the others.

• **Policies affect risk management.**

Many programs have been put in place to help farmers manage risk. They include crop insurance, credit, price supports, tax management, the conservation reserve, and ad hoc disaster payments. Each program has pluses and minuses that differ according to the size and structure of farms. Policies, however, *reduce* risk; they rarely *remove* risk from agriculture. Since most farmers have a certain threshold of risk that they are willing to accept, these programs pay farmers to take on added risk. In some cases, policies can act as perverse incentives by, for example, increasing plantings in marginal areas.

Government programs also have pluses and minuses at the societal level. While they are intended to support prices, this often results in increasing the expected returns and stimulating more production. This result causes the commodity programs to decrease the price for, and reduce the risk of, crops in those programs: creating a ready supply of those crops, but also creating the potential for a market glut. In addition, they narrow the range of crops grown. That is, program crops “crowd out” other crops, which may reduce biological diversity as well as consumer choice.

Ownership Counts.

For small farms or large, part of the benefit from commodity programs goes to the landowners. Why? Because land is the only long-term fixed asset in agriculture—its supply is limited. Therefore, some of the expected returns to farming assets (including program payments) are capitalized into land values.

To see this, consider that from 1996 (when the FAIR Act went into effect) to 2000, average farmland prices in the 48 states increased annually by nearly 5 percent despite the fact that agriculture would not have done well at all were it not for government payments.

Obviously, the owners of the farmland—whether they themselves farm it or lease it to farmers—are the beneficiaries of the increased land value. And since over 50 percent of U.S. farmland is leased, landowners who are not farmers may share substantially in the program benefits.

Rural Development is Critical.

Given that so many farm households depend so heavily on off-farm jobs and income (less than 25 percent of farm families get the majority of their income from farming and only 15 percent of the total income earned by farm households nationwide comes from farming), the importance of the rural economy to farming cannot be overstated.



From Description to Prescription

The previous analysis provides a critical first step in understanding the lay of the land (itself a critical first step in formulating successful farm policy). Still, the analysis is only a first step. To consideration of farm size, ownership, risk, and rural development—that is, horizontal issues—must be added consideration of vertical issues—contracting, supply chain management, integrated operations, and the like. Consequently, C-FARE, as part of its ongoing effort to help inform public policy, will deal with those issues in a forthcoming publication.

Description, however, does not translate directly into prescription; policy analysis cannot be equated to policy formulation. To move from description to prescription, other questions must be addressed—questions whose answers are decidedly subjective. For example:

- Should farm policy support people or commodities?
- What does a predominantly urban/suburban population think about farm policy, especially periodic farm bailouts?

- Who should be the target beneficiary of farm policy? Producers? Consumers? Landowners? Lenders? The environment? All of the above?
- What mechanisms should be used to achieve farm policy goals?
- Finally, what exactly do we as a nation want from farming?

Clearly, the answers to such questions depend upon whom you ask. So too, does the answer to the question “Have past policies failed or succeeded?” Which is precisely why objective analysis is so important. Without it, policymakers would be hard pressed to weigh the many perspectives and their various proposed solutions. Indeed, without a complete and accurate understanding of the lay of the land, farm policy cannot achieve what we as a nation want from farming.



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C-FARE is a non-profit and non-partisan professional organization of agricultural economists working to bring the results of economics research to key public sector decision makers in the Administration and the Congress.

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American Farm Bureau Federation – handouts

For more information on the views of the National Farmers Union or the American Farm Bureau Federation, please visit their websites: <http://www.nfu.org/>
<http://www.fb.org/>

1 Average costs – total costs divided by total output.

2 Economies of size and scale – The concept that the average cost of production per unit declines as the size of the operation grows.

3 Total costs – the sum of all overhead and variable costs.

4 Residual Risks – the risk that remains after legal and financial risks are accounted for.

5 Equity Capital – the money a firm’s owners supply directly to the firm.

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