



# Overview of Farm Savings Accounts (FSA) Alternatives

*Michael Boehlje, Joshua Detre, and Allan Gray, Department of Agricultural Economics, Purdue University*

A frequently identified goal of U.S. farm price and income support programs is to reduce the income risk that farmers face—to provide a “safety net” that would reduce the chances of financial failure or inadequate incomes to support family living. In addition to direct payments to farmers and subsidies for crop insurance, it has been suggested that farmers might be encouraged by government policy to invest in savings accounts, with the funds being available not only to mitigate financial risk, but also to pay expenses during the retirement years.

This savings account has been suggested as both a full or partial replacement for existing farm program payments. In essence, the focus of such programs would be to encourage farmers to allocate funds in high-income years to financial reserves that are available to pay farm and family living expenses in low-income years. This publication presents the general ideas behind a farmer savings account to help readers better understand how it might be a part of future farm policy.

A government-assisted farmer savings program could be implemented in a number of ways. Here are three possibilities (among many).

- Government payments could be directly deposited in qualified savings accounts, with the opportunity for additional voluntary contributions from farm income.
- Special savings accounts could be created for farmers where funds deposited would be tax deductible or receive other tax advantages. Earnings in such accounts could be allowed to

accumulate on a tax-free basis similar to what is now allowed with qualified retirement accounts, college savings accounts, etc.

- Government bonds that carry higher than market rates of interest could be issued as special savings instruments for qualified participants in a farmer saving program.

## **Review of Various Farm Savings Account Proposals Net Income Stabilization Accounts**

Various forms of Farm Savings Account (FSA) programs have been proposed or are currently used in other countries. Canada has implemented such a program, the Net Income Stabilization Account (NISA) program. Under the Canadian NISA program, agricultural producers can make voluntary contributions into a NISA using two different deposit methods.

The first method allows the producer to deposit up to 3% of eligible net sales (maximum net eligible net sales is \$250,000 Canadian) that is matched by an equal contribution from the government (2% federal and 1% the provincial government). This caps government expenditures to a maximum of \$7,500 per year per farmer (Coble, 1995; Spriggs and Nelson, 1997; Rude, 2000; Culver et al., 2001). Net eligible sales (NES) are defined as revenue from sales of qualifying commodities (excludes poultry, dairy, and eggs) produced on the farm, minus any purchases of qualifying commodities, plus the value of any feed produced for on-farm livestock consumption.

With the second deposit method, there are no government contributions, and the farmer is able

to deposit up to 20% of net eligible sales (maximum net eligible net sales is again \$250,000). All producer contributions receive a 3% bonus return above a competitive interest rate at a cost to taxpayers, while government contributions earn 90% of the 90-day Treasury bill interest rate. All money contributed to the account by the producer is in after-tax dollars; therefore, tax is only paid on the interest earned and government contributions when money is withdrawn.

Farmers may make withdrawals when one of the following two triggers is met: 1) income falls below their five-year average net returns after costs, or 2) when taxable income falls below a fixed level. The amount of money that may be withdrawn from the account cannot exceed what is necessary to equate this year's income with one of the aforementioned thresholds.

Two exceptions are allowed to the withdrawal rule: 1) the farmer retires, or 2) the farmer chooses to withdraw from the program. The farmer may then choose to withdraw all remaining funds from the account. The accounts cannot be overdrawn.

#### **Farm and Ranch Risk Management Accounts**

The USDA Commission on 21<sup>st</sup> Century Production Agriculture (2001) suggested a U.S. version of the savings account, Farm and Ranch Risk Management (FARRM) accounts. FARRM accounts would have all contributions tax deferred, in contrast to the NISA framework, where only the government contributions are tax-deferred and producer contributions are after-tax dollars.

Farmer contributions under the Canadian NISA program are treated as they would be in a Roth IRA. For the alternative U.S. proposal, it is expected that for years when funds are deposited in the account, the farmer will likely be in a higher tax bracket than in years when money is withdrawn. The Commission's proposal would use the FARRM accounts as a supplement to other farm programs.

#### **FSAs Similar to 401(k) Accounts**

The Chicago Council on Global Affairs suggested in a recent Task Force report, *Modernizing America's Food and Farm Policy*, that farmer savings accounts could be a critical component of new forms of domestic producer support that are risk reducing and also less trade distorting (and perhaps WTO compliant) than

current price and income support programs. The Council proposes: "Farmer savings accounts would be similar in structure to tax-deferred 401(k) accounts. They would be backed by government matching contributions and could be tapped by farmers for a variety of uses, including farm household costs, health care, education, or retirement. Matching payments for individual contributions could be designed to meet specific needs of a particular farm family. Farmers nearing retirement might elect payments into a 401(k), while younger farmers might opt for payment into a health account" (p. 41).

#### **Farm Income Stabilization Account Act of 2007**

Senator Richard Lugar (R-IN) has offered the most recent proposal for farm savings accounts, the Farm Income Stabilization Account Act of 2007. This proposed program would replace current government payments to farmers under the Commodity Title of the 2002 Farm Program with government contributions to savings (FISA) accounts. The accounts would be seeded by government contributions determined as a percentage of the participating farmer's "adjusted gross revenue," with the percentage contribution declining with higher gross revenues (incomes).

Government contributions to the FISA account would also be made for land and water stewardship and conservation practices under a tiered payment structure similar to the three-tiered Conservation Security Program (CSP). Producers could make voluntary tax-deferred contributions to the account up to \$10,000. Withdrawals from the account could occur when "adjusted gross revenue" for a year declines to 95% of its average level in the prior five years, or for value added farm investments.

#### **Comments**

A key benefit attributed to FSA programs is the accumulation of a liquid pool of funds to access in periods of financial stress as well as providing financial diversification for farmers (Monke and Durst, 1999; Edelman, 2000). Instead of the farmer investing available cash back into the farming operation in high net-revenue years, at least some of the free cash could be deposited into the FSA. If a farmer or the government has deposited funds in the account, the funds can be withdrawn to meet household consumption needs during years with insufficient income.

In essence, the FSA is designed to function much like a counter-cyclical payment, which provides a safety net in times of financial stress, but it is different from the counter-cyclical payment in that it is not tied directly to parcels of land, creating a disconnect (albeit, not a perfect disconnect) between land values and government support. By creating this disconnect, the capitalization of farm programs into farmland values may be reduced. In addition, investment returns on the FSA account are likely not positively correlated with the returns to the farm operation, allowing the farm operator some income protection in times of low farm income.

The FSA could provide the farmer with funds to be used to service debt (in low cash-flow years), thus reducing the possibility of default on a loan. If a FSA account is held by a local financial institution, more deposits might be available for local loans, thus creating the potential for increased economic development in rural communities. Local deposits have not been suggested in any FSA proposals to this point but could be considered as part of a rural development strategy.

Incentives or regulations might be used to encourage farmers to invest a portion of government payments received through income support in such savings accounts rather than being used to bid up land values or cash rents. However, it should be recognized that “encouraged” farm savings are most attractive where farm debt levels are low. Otherwise debt repayment may be a more attractive option.

One of the main problems with FSA programs is building a meaningful fund balance in the early years of the program or for farmers with persistent low incomes (Dismukes and Durst, 2006). Freshwater (2002) indicates that NISA balances are much higher for the most profitable quintile than for the less profitable quintile of Canadian farmers irrespective of the size of the farm.

Farmers with low levels of farm income might be precluded from building meaningful account balances (i.e., a sufficient amount of funds necessary to cover poor income years) and thus would be unable to achieve any benefits from the program. The government might provide a means to build meaningful account balances through transfers similar to those proposed by Senator Lugar.

Another issue with FSA programs is the will of Congress to let them work. The long-term key to success of this type of program will hinge on Congress’ willingness to reduce the use of disaster payments and let the farmers’ savings accounts be used to meet shortfalls when economic or natural disasters occur. If that willingness is not there, taxpayers could end up funding farmer savings accounts and still have to fund disaster payments as well.

## Final Comments

Farm Savings Account (FSA) proposals attempt to encourage or induce farmers to develop financial reserves to manage income risk from low yields or prices. Such accounts can be funded by farmer contributions, government payments, or a combination of the two. FSA programs could provide not only liquidity and a safety net for low-income years, but also reduce financial risk by encouraging farmers to diversify their asset holdings into financial assets rather than land and farm business assets. As the 2007 Farm Bill unfolds, the possibility of incorporating at least a pilot of farmer savings accounts is likely to be debated.

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