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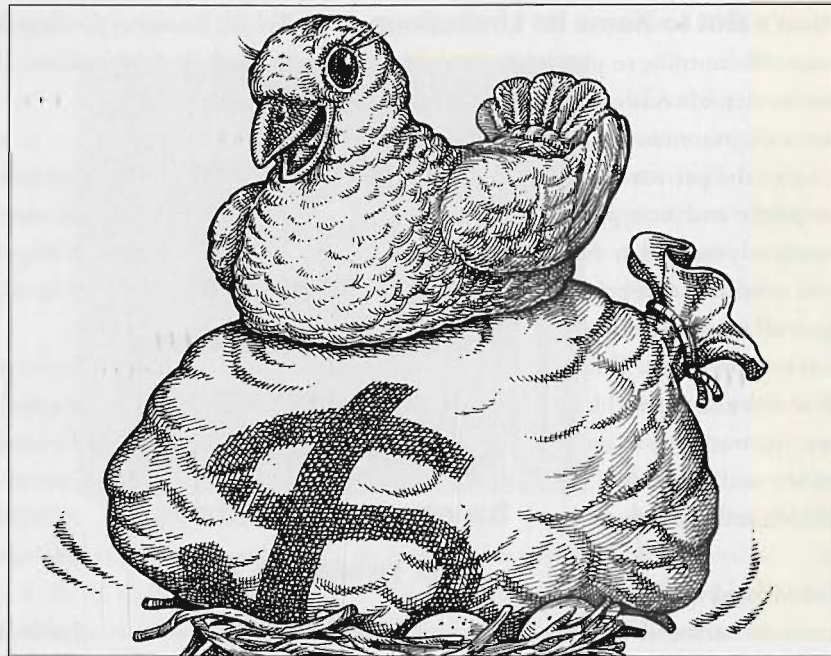
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# Can Farmer Savings Accounts Help Save Farming?

**Nest eggs:** Farmer savings accounts of various types have been posed as a potential solution to cyclical income problems for years. Will the next Farm Bill actually cross the Rubicon and include some form of FSA program?



BY MARK A. EDELMAN, JAMES MONKE, AND RON DURST

Despite a largely merited reputation for thrift, farmers in the United States do not generally save for bad times. In contrast, Canada encourages farmer saving by matching their deposits and providing interest rate bonuses. In Australia, a relatively new program allows farmers to defer taxes on savings deposits in good years so the savings can be withdrawn at lower tax rates during poor years. Although Congress has debated farmer savings concepts off and on since 1996, the United States has not yet implemented a specific farmer savings account program. However, a savings program may emerge, either in the 2002 Farm Bill debate or as part of a broader tax package. We describe four possible savings account concepts to show the potential role that farmer savings incentives might play in future U.S. farm policy.

## Option 1: Net Income Savings Accounts (NISA)

Canada implemented a Net Income Savings Account program in 1991. Under the program, a farmer who

makes a deposit into a NISA account receives a government matching deposit up to three percent of Eligible Net Sales (ENS) — defined as gross sales of qualifying commodities less purchases of seed, plants, and livestock. The Canadian government then pays a three percent interest rate bonus over local bank rates on all NISA deposits.

The maximum ENS eligible for matching is limited to C\$250,000 per year per farming entity, so the maximum match is C\$7,500 per year. Farmers can deposit up to 20 percent of ENS per year without a government matching deposit. Each entity is subject to a maximum NISA balance of 1.5 times the 5-year average ENS. Unused deposit allocations can be carried forward for up to five years.

NISA withdrawals can be made under either an “Income Stabilization” trigger when the farmer’s current year gross margin falls below the average gross margin for the five previous years. (Gross margin is roughly analogous to the IRS’s Schedule F Gross Farm Income.) Alternatively, withdrawals can be made under a “Min-

imum Income" trigger when the farmer's current net income from all sources falls below a threshold level — C\$20,000 per individual or C\$35,000 per family.

NISA is a voluntary program, used by slightly more than half of all Canadian farmers. Farmers may leave and rejoin under specific rules, and are required to opt out if they quit farming or retire. NISA does not replace other Canadian farm income programs. Subsidized crop insurance and government funded NISA incentives are farm program mainstays north of the border. While Canada maintains an ongoing supplemental disaster assistance program, it does not provide farm supports analogous to Agricultural Market Transition Act (AMTA) payments and Commodity Loan Programs.

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

U.S. proposals for Farm and Ranch Risk Management (FARRM) accounts originally appeared during the 1996 Farm Bill debate. Under FARRM, there are no matching deposits, interest rate bonuses, or income triggers for withdrawals. Instead, deferred taxes encourage farmer savings account deposits. Farmers would make FARRM account deposits as an additional deduction from pre-tax income. Deposits would be held in interest-bearing accounts at approved financial institutions. Interest earnings would be distributed to the farmer and taxable in the year earned. Withdrawals from FARRM accounts would be made at the farmer's discretion and taxable in the year withdrawn.

Under the most recent proposal, farmers could deposit up to 20 percent of eligible net farm income annually. While there are no limits on account balances, FARRM deposits could only stay in the account for up to five years, with deposits not withdrawn in 5 years incurring a 10 percent penalty. Withdrawal of FARRM funds would be required if the account holder did not farm for two consecutive years.

### **Option 3: Individual Risk Management Accounts (IRMAs)**

Individual Risk Management Accounts (IRMAs) are voluntary and contain a combination of deferred tax

and government matching deposit incentives. Similar to FARRM accounts, IRMA deposits are deductible from pre-tax income. Deposits and interest are taxable only upon withdrawal. A farmer would voluntarily deposit a minimum of two percent of Schedule F gross farm income each year into an IRMA account. The federal government would then make a two percent matching IRMA deposit.

IRMA is viewed as a tool for self-insurance. Therefore, IRMA farmers can expect to receive government subsidies roughly equivalent to those who benefit from subsidized crop insurance. However, IRMA participants are expected to deposit contributions similar to those made by farmers who purchase crop insurance premiums. Farmers receive catastrophic crop insurance (CAT) coverage under IRMA, but any additional crop insurance purchased by an IRMA participant may not be subsidized.

Similar to NISA, farmers can maintain maximum IRMA balances of no more than 150 percent of the their 3-year average Schedule F Gross Farm Income. Farmers may withdraw only during years when their Schedule F Gross Farm Income falls below 80 percent of the average for the previous three years, and the withdrawal can only be used to bring the income up to the 80 percent level.

### **Option 4: Farm Program Payment Reserve (FPPR) Accounts**

A fourth alternative is similar to the FARRM account concept introduced in 1996. Under this option, AMTA payments are linked and diverted to savings accounts to build safety net reserves for individual farmers. If such FPPR accounts had been in effect in 1996, payments in the high-income years (1996 and 1997) would have generated savings account balances so that each farmer receiving AMTA payments would have had a safety net during the lower income years that followed.

If an FPPR-like plan specifies that 50 percent of future AMTA payments and other fixed farm program payments must be deposited into FPPR accounts in the name of each program participant, the plan would convert half of the fixed payments into a counter-cyclical payment program.

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Similar to NISA, FPPR accounts 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 he or she reaches the FPPR account maximum. Withdrawals could be triggered when current year gross farm income 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.

### What's at Stake for Stakeholders

Savings programs can help farmers manage risks and create a personal financial safety net. To the degree that the farmer's net savings increase, assets accumulate and the farmer's investment portfolio becomes more diversified. The program also represents a form of self-insurance that builds assets rather than adding premium expense. However, the level of exposure to risk depends on the previous accumulation of each farmer's reserve balances.

Farmer savings account incentives represent one approach to meeting the emerging WTO criterion of supporting farmers in a non-trade-distorting manner. The payments and incentives are not linked to crop-specific prices or levels of production. In addition, farm program parameters based on farm income may become a more useful tool as the structure of agriculture and the food system shifts away from commodity prices on open markets and toward contracting and integrated value-added product markets.

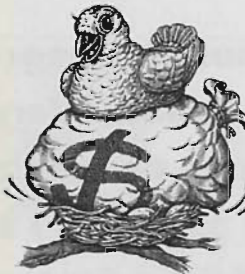
Taxpayers and consumers are potentially interested in such concepts because farmers may come to rely more on safety nets that reduce reliance on government disaster programs or subsidized insurance programs.

The various consequences for each of the four farmer savings account programs are listed in Table 1. A comparison of the participation, farm management, program impact, and fiscal attributes of the four concepts emphasizes the trade-offs among them.

FARRM, the most widely discussed U.S. proposal, would likely generate the least farmer participation. However, proposals that generate greater voluntary participation likely require greater monetary incentives such as matching payments and interest rate bonuses. Deposit and withdrawal requirements may be less popular in farm country but do more to assure taxpayers that a

safety net is constructed during good times with adequate reserves for use during the poor years.

The key policy issue to emerge from comparing the four alternatives is to determine the priority of goals for the farmer savings account incentives. Should the primary goal of the incentives be to make AMTA payments more counter-cyclical, to provide a supplemental risk management tool, to foster self-insurance as a substitute for subsidized crop insurance, or to build safety net reserve balances that reduce the need for future ad hoc disaster programs? The level of agreement on policy goals is likely to shape the design and the choice of the option that provides the best fit in terms of its intended consequences.



### For More Information

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Mark A. Edelman is Professor of Economics at Iowa State University. James Monke is a senior economist with the Economic Research Service of the U.S. Department of Agriculture. Ron Durst is with the Economic Research Service of USDA. The views expressed in this article do not necessarily represent those of USDA or the U.S. government.

