FARM BILL 02 CHOICES

Is Agriculture a "Way of Life" or a Business?

BY STEVEN C. BLANK

The title question cuts to the core of the agricultural policy debate in the United States. Do current farm policies support competition-beset businesses, support "lifestyle hobbies," or something else?

It seems as though every time American agricultural policy comes up for discussion — particularly in Washington — someone proclaims the need to protect the "way of life" offered by "family farms." At various points in the discussion, family farms may also be referred to as "family businesses." In the language of the U.S. Department of Agriculture (USDA), those family farm businesses are sometimes referred to as "owner-operator households." The terminology gets a bit confusing at times, but one thing is clear: it is important to examine the embedded issues before confronting the conflicting forces underlying the current agricultural policy debate. As a start, we need an answer to the question: "Is agriculture a way of life or a business?"

This question cuts to the heart of agriculture and to agricultural policy. In policy debates agricultural proponents have often used the "way of life" argument to support their claim that production agriculture, in general, and family farms, in particular, need to be protected in various ways — such as subsidization through direct and indirect government payments. That long-held position asserts there is something special about agriculture that deserves to be preserved. However, an economically viable business does not need protection. In addition, economically viable, mature businesses are rarely the subject of policy debates. Thus, arguing that agriculture needs protection is equivalent to arguing that agriculture is not a viable business.

A Look at the Record

Certainly, agriculture was a business at some point in our history. As Cochrane details, agriculture was America's main industry early in our history. As our economy developed, other industries grew, but agriculture must have still been a profitable "business" into the twentieth century because it continued to attract resources, growing in numbers of firms until 1935 and in total acreage until 1954.

However, agriculture over the past half-century has been shrinking in size, importance, and economic performance (Blank). The economic development literature explains agriculture's decline by noting that "if resources are free to move, other things being equal, they will move in the direction of higher returns" (Mundlak). That type of profit-maximizing behavior is expected of a business, and agriculture has done a good job of moving human resources out of the sector over time. So why do agricultural producers stay where they get a return on equity averaging only about 1.5 percent in recent decades, far below returns available elsewhere in our economy?

Are farmers "profit maximizers" and wealth builders like businesses, or "utility maximizers" and happiness builders focused on a way of life?

Clearly, agriculture is viewed as more than a business now. Many individuals in agriculture are making an economic sacrifice to be there. Do people work in agriculture because it is a "better" lifestyle, or because an urban lifestyle is "worse"? The reverse migration from cities to small farms observed over the past decade suggests the first (Deller et al.), the reluctance of farmers to leave agriculture suggests the second (Goetz and Debertin 1996, 2001; USDA 2000). The number of farms with annual sales of less than $10,000 has increased since 1992 as more Americans pursue a rural lifestyle. The reluctance of farmers to leave the industry is evidenced by their willingness to accept agriculture's low returns.

The debate over why farmers keep farming dates back many decades. Typical of the arguments are those Brewster advanced in the 1960s, and Ikerd more recently. Brewster hypothesized that farmers willingly accept lower returns than other investors because of the lifestyle they derive from farming. Ikerd raises related issues, with a religious fervor that includes a reference to the Dalai Lama.

Brewster's hypothesis implies that farmers are not sensitive to foregone opportunities off the farm. It explains why some farmers might exclude non-agricultural investments from their portfolio, limiting themselves to agricultural production opportunities. On the other hand, the fact that most farmers are part-timers indicates that farmers are indeed sensitive to off-farm opportunities and will pursue them if able (Mishra and Sandretto). The USDA (2002) reports that for large family farms (those with annual sales of $250,000 to $499,999) "about 50 percent of the operator households reported that either the operator or the spouse did some off-farm work." This implies that farmers, like all investors, have a desire to build wealth, which is consistent with the view that producers see agriculture as a business.

Thus, farmers' behavior sends mixed signals: some seem to be pursuing a lifestyle while others act like business managers. It is also likely that many farmers are pursuing both lifestyle and business goals. We need to ask: "What is their objective?" Are farmers "profit maximizers" and wealth builders like businesses, or "utility maximizers" and happiness builders focused on a way of life?

Profit is the Key

A dictionary definition of "business" is "a commercial or industrial enterprise," and a definition of "commercial" is "designed for profit or for mass appeal." Clearly, profit is the key to answering the question. Also, the USDA has made it clear that profit performance is related to the structure of American agriculture. Thus, it is useful to assess the agricultural profit performance of farm owner-operators grouped according to size. "Commercial farms," defined by the USDA as those having annual sales of $250,000 or more, represent only 8.2 percent of U.S. farm businesses. They are expected to have average net cash income of $117,800 per farm in 2002, compared to their 1996-2000 average of $141,800 (USDA 2002). "Intermediate farms" (defined as those with sales below $250,000 yet whose operators report farming as their major occupation) represent 28.9 percent of farm businesses and are expected to have average net cash income of $7,200 in 2002, compared to their 1996-2000 average of $12,300 (USDA 2002). "Rural residence farms" account for the remaining 62.9 percent of farms and are expected to have average net cash income per farm of -$2,800 in 2002, compared to their -$1,800 average for 1996-2000 (USDA 2002).

Clearly, large commercial farms are building wealth through agricultural profits, so they are behaving like businesses. The average profit level for these farms is sufficient to support a family without off-farm income.

Intermediate farms are more ambiguous in their objectives. These operators report farming as their major occupation and they do make a profit (as calculated by the USDA), but the level of profits, on average, is not sufficient to support a family. Therefore, it is unclear whether these farmers are seeking to maximize their profits or their quality of life (utility).

Because small-farm owners know they are losing money, on average, it seems reasonable to assume that they would quit farming if they were rational profit seekers. By not quitting, it appears that their primary objective is not profit from farming. Thus, they appear to be "hobby" farmers who consider the time and labor spent in farming as leisure.

A dictionary definition of "hobby" is "a pursuit or interest engaged in for relaxation." A hobby is therefore a leisure activity with the primary objective of increasing a participant's happiness (utility), not his profit. Hobbies have a cost that participants must pay to play. Anything taking time and money to play must be leisure with an intrinsic value equaling foregone wages and returns from capital invested, minus the expected financial result (loss).

Let's look at an example: a man named Steve, who likes to play golf. For Steve, golf is a favorite hobby that relaxes by taking his mind off his for-profit activities (his livelihood) for a while. The intrinsic value of golf is the total of Steve's foregone wages (the money he could earn during the time he spends golfing) plus capital costs (the gains foregone on the amount invested in golf equipment) and the direct costs of the greens fees and equipment he uses while playing. Although Steve has been known to win a few dollars in club tournaments, that total in any year has always been below his total direct costs of playing golf. Therefore, golf is not a business to Steve.

For hobby farmers, the same logic applies. A business seeks to increase the wealth of its owners by earning profits. For rural residence farms, owners' wealth is reduced by the average losses incurred. Therefore, the objective must be lifestyle-oriented. Small-scale farmers voluntarily "pay to play," implying that leisure time spent pursuing a farming hobby is not valued at zero, nor at the opportunity cost of foregone wages, but at the difference between foregone wages plus gains on capital invested and after-tax financial gains from farming. Yet, with profits expected to be negative for most small-scale farmers, the expected value of leisure exceeds wage rates and capital costs.

A simple decision rule can indicate whether a particular small or intermediate farm is a business or a lifestyle choice. In general, the rule is if the expected value of leisure is less than 0, the farm is a business; if greater than 0, the farm is a lifestyle choice (see "Business or Lifestyle" p. 29).

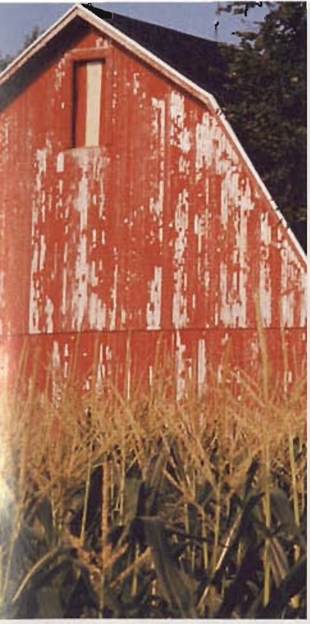
In essence, if operating profits are expected to outweigh foregone gains, then the farm is operating like a business. When the foregone gains are expected to be greater than the profits earned, the farm is a hobby with utility maximization as its objective.

Table 1. U.S. Farm Income, 1998-2002 (all farms)

	1998	1999	2000	2001	2002F
			$ billion		
Crop receipts	101.7	92.6	94.1	95.8	97.9
Livestock receipts	94.1	95.6	99.5	106.1	106.4
Total cash receipts	195.8	188.1	193.6	201.9	204.3
Net farm income	42.9	44.3	46.4	49.3	40.6
Direct government payments	12.4	21.5	22.9	21.1	10.7
Adjusted production income*	30.5	22.8	23.5	28.2	29.9
			$ per farm operator household		
Net cash farm income	14,357	13,194	11,175	10,888	8,006
Earnings from farming	7,106	6,359	2,598	2,447	–198
Off-farm earnings	52,628	57,988	59,349	59,943	59,343
Average farm household income**	59,734	64,347	61,947	62,390	59,145

Source: USDA 2002 F = forecast

* This is calculated as net farm income minus direct government payments. ** This is the sum of "earnings from farming" and "off-farm earnings."



Answer to the $64,000 Question

So here's the answer: agriculture is both a way of life and a business. More precisely, it is a way of life to — possibly — all participants, but it is a business only to some. Large-scale commercial farms clearly act like businesses. However, many of those farm operators may also view their business as a desirable way of life. On the other hand, rural residence farms are hobbies that operators must subsidize with earnings from off-farm sources.

The magnitude of the voluntary subsidy by small-scale operators to their hobby farms now swamps the profit performance of larger farms. As shown in Table 1, the average earnings from farming for all American farm households is expected to be negative in 2002 (-$198 per household) because total losses from the large group of hobby farms is greater than the total profits from commercial operations.

Finally, note that a hobby farmer's willingness to pay-to-play depends on his/her initial wealth, along with the cost of leisure. This means people will play when their lifestyle budget (which includes the total cost of hobbies) is met by income from normal non-agricultural sources. As shown in Table 2, an average "farmer" can afford to pursue a rural lifestyle because, although farming results in a loss of $198 per year, average off-farm income of $59,343 is sufficient to support the operator and family as they enjoy their rural home.

Policy Implications

The results of this assessment of farmer objectives raise at least two policy questions. First, should agricultural producers be subsidized? Second, should policy facilitate "fragmentation" of agricultural land?

Farm policy has always claimed to have the goal of supporting agriculture because it is an important part of our economy (Bonnen and Schweikhardt). However, if agriculture is a "lifestyle" choice, it becomes impossible to justify government support. At present, about 62 percent of farms are "residential" in scale, lose money on average, and adversely affect commercial farmers by bidding up input prices and adding to total product supply, thus putting downward pressure on commodity prices. It does not make good business sense for the country to have taxpayers subsidize these activities any more than other hobbies.

Yet current subsidies include income tax breaks, as well as direct government payments totaling billions of dollars each year (Table 1). The fact that most of that money goes to large farms adds fuel to the argument that much of agriculture is no longer economically viable, when evaluated without the government payments currently included in the "net farm income" reported by the USDA.

According to the current logic in farm policy, Steve should be able to deduct the costs of pursuing his golfing hobby from his income. Participating in hobby farms and hobby golf are both voluntary decisions made by individuals knowing that their economic outcome will be a negative cash flow. However, the only way Steve can deduct his hobby is to call it a "business expense," as do corporate golfers when they entertain clients.

The lifestyle-driven reverse migration from cities to rural areas creates demand for small parcels, thus spurring "farmland fragmentation." Fragmenration occurs when

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Business or Lifestyle:
A Mathematical View

It is possible to represent the business-vs.-lifestyle calculation symbolically. A hobby farm has a "hobby" value (H). As described in the text, the value of the time spent farming (assumed to be leisure time, because farm income cannot support the household) is:

$$\mathbf{H = (w + k - \pi)}$$

where
w = opportunity cost of foregone wages
k = gains on capital invested
π = after-tax financial gain from farming

Because the average lifestyle farmer loses money farming ($\pi < \$0$), the expected value of the leisure derived must be greater than the sum of foregone wages and capital investment costs:

$$\mathbf{E(H) > w + k}$$

where
k = return on invested capital,
or
k = (K)v, where
K = actual capital invested
v = % rate of return on the investment.

The decision rule determining whether a farm is a business or a lifestyle choice can be rendered as follows:

if E(H)
< 0 , the farm is a business;
> 0 , the farm is a lifestyle.

larger parcels are broken into smaller parcels. In the aggregate, this trend creates problems for the agriculture sector. As noted above, large commercial farms are more often profitable. This implies that agricultural income could be raised by consolidating small farms into large farms — the reverse of fragmentation.

However, it is medium-sized farms that are more often consolidated into large farms. Small farm owners do not like being forced out of agriculture, and they resist this resource reallocation by subsidizing their farms with off-farm income. Current policy facilitates fragmentation by being lifestyle-friendly. In essence, the subsidized lifestyle choices of rural residence farmers are helping to reduce the viability of commercial farms by breaking land into smaller parcels, making it more difficult for commercial farmers to find and afford farmland on which they can achieve economies of scale in production.

One last policy dilemma emerges: small farms fragment agricultural land, but are entry-level operations for many aspiring young farmers who may represent the future of American agriculture (Gale). Thus, size alone is not a sufficient base for policy decisions. Many small-scale farmers have profit-maximization as their objective and, therefore, may deserve assistance through policy efforts. However, "lifestyle" operations are no better investments for our country than are any other hobbies.

For More Information

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