Staff Paper 333

Canadian Net Income Stabilization Accounts and Other Options for Achieving Counter-Cyclical Program Payments with Planting Flexibility

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Background Discussion Outline

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Abstract

This discussion outline describes the Canadian Net Income Stabilization Account (NISA) concept; provides comparisons to U.S. proposals for Farm and Ranch Risk Management (FARRM) and Individual Risk Management Accounts (IRMA); and compares these concepts to other selected policy options with respect to the counter-cyclical nature of payments and planting flexibility criteria.

Staff Paper 333 embodies the discussion outline used by the author in presentation to the National Commission for 21st Century Production Agriculture. The 1996 FAIR Act established the Commission to develop recommendations on future U.S. Farm Policy for the Congress and the President prior to expiration of the current farm policy.

Canadian Net Income Stabilization Accounts and Other Options for Achieving Counter-Cyclical Program Payments with Planting Flexibility

Discussion Objectives:

- Describe the nature and context of the Canadian Net Income Stabilization Account (NISA) concept.

- Compare the NISA concept to U.S. proposals for Farm and Ranch Risk Management (FARRM) and Individual Risk Management Accounts (IRMA).

- Compare the savings account concepts to other selected policy options with respect to the counter-cyclical nature of payments and planting flexibility criteria.

I. The NISA Concept:

- Federal Govt. matches farmer NISA deposits up to 3% Eligible Net Sales (ENS). (Gross Sales of qualifying commodities less Qualifying Purchases such as seed, plants, livestock purchases.)

- Maximum ENS eligible for match is limited to $250,000 per year per entity. So, maximum Govt. match is $7,500 per year.

- Some Provinces offer enhanced matching contributions above 3 % level.

- Farmers can deposit additional non-matchable deposits above 3% up to 20% ENS per year with no Govt. match.

- Govt. pays 3 percent interest rate bonus on farmer deposits over bank rate.

II. The NISA Process:

- Farmers make application and deposit to their NISA Fund I account at their own banking institution.

- Annual deadline: Individual - June 15th; Entities- June 30th; Application Fee $55.

- Entitlement is reduced 5% per month for late applications up to December 31st.

- Govt. matching funds and interest payments are deposited in a NISA Fund II account held by Govt.

- Farmer uses after tax dollars for farmer deposits.

- Interest earnings and Govt. matching funds become taxable upon withdrawal.

- Unused matchable deposit allocations can be carried forward 5 years.

- Max NISA balance: 1.5 times 5-year average ENS.

- No additional funds can be deposited until balance falls below ceiling.

III. NISA Withdrawal Triggers:

1. Stabilization Trigger:

- A farmer's current year Gross Margin falls below the average for farm for up to 5 previous years. Participation for one year is required to use this trigger.

- Gross Margin equals Net Sales from all ag commodities, plus income from contract work and machine rental, minus eligible expenses.

2. Minimum Income Trigger:

- Farmer's current year net income from all sources falls below a threshold level plus matchable deposit. (Raised 6/21/99 from $10,000 per individual or $20,000 per family to $20,000 per individual or $35,000 per family.)

IV. Deeming a Deposit

- Farmer may use triggered withdrawal to make all or part of matchable deposit. This allows a farmer to make a matchable deposit to receive the Govt. match in a year with low cash flow.

- If the triggered withdrawal is less than the matchable deposit, the farmer can only deem up to the amount of the trigger. If the farmer wishes to deposit the rest of maximum matchable deposit, it must be accomplished from the farmer's own resources.

V. Interim Withdrawals (Advanced Payments)

- Introduced June 1998 (Annual Application Deadline is December 31st.)

- Allows farmer to receive withdrawal funds from his/er NISA account in the year in which financial need arises.

- The farmer's Maximum Actual Withdrawal Trigger is reduced by the Interim Withdrawal amount.

- If the Interim Withdrawal exceeds the Maximum Actual Withdrawal Trigger entitlement by more than 10 %, an overpayment charge of 3% of the excess withdrawal amount is charged to the farmer.

- A farmer has one year to repay the overpayment amount and overpayment charge into the Fund I Account.

- Failure to repay by deadline results in mandatory opt out of the NISA program.

- Partial payment does not result in extension of deadline.

VI. Closing a NISA Account

1. Voluntary Opt Out

- Notify NISA in writing anytime and request lump sum or annual installments for up to 5 years.

- If you voluntarily leave you can rejoin NISA in one year by repaying previous NISA balance or rejoin NISA in two years without repaying previous balance.

2. Mandatory Opt Out

- Failure to complete application for two years causes mandatory opt out.

- Failure to complete application after receiving Interim withdrawal

- Failure to repay overpayment of interim withdrawal within 1 year deadline.

- Balance paid in lump sum. Must miss 2 consecutive years before rejoining NISA.

VII. Canadian Farm Economic Facts

- 276,550 Canadian farms according to 1996 Canada Ag Census.
- 1998 Canadian realized net farm income $2.5 billion (After depreciation)
- Canadian NISA balances: January 1999 $2.8 billion

Table 1. Canadian NISA Participants and Balances Oct. 1998

Sales Class	Participants	Average Account Balance
$0 to $49,999	60,799	$5,727
$50,000 to $99,999	31,665	$12,879
$100,000 to $249,999	33,799	$23,766
$250,000 to $499,999	9,844	$40,744
$500,000 or more	4,910	$83,934
Total*	143,738	$16,614

* Data change daily. Often more than one participant per large farm. Includes some unallocated accounts.

Source: Agriculture and Agro-Food Canada, March 1999

VIII. The Big Picture of Canadian Farm Policy

- Phased out of Government Gross Income Revenue Insurance (GRIP) by 1998--too costly.
- Private Crop Insurance Subsidized by Government.
- Net Income Stabilization Accounts
- Agricultural Income Disaster Assistance (AIDA)
- No AMTA or Deficiency Payments
- No Marketing Loans or LDP Payments

Table 2. Canadian Federal Government Gross Direct Payments - $ millions

	1994	1995	1996	1997	1998f	1999f
NISA	41	46	115	153	224	427
GRIP	542	185	32	23	0	0
Crop Insurance	435	328	276	313	309	450

Source: Agriculture and Agro-Food Canada, March 1999.

IX. Canada's Agricultural Income Disaster Assistance (AIDA) Program

- Special 2 year program for 1998 and 1999.
- AIDA funded 60% by national - 40% by Provinces.
- Eligibility: Income Tax Filers whose Gross Margin falls below 70% of up to 5 year average.
- Special calculation for beginning farmers.
- Extended/: Minister VanClief Announcement 1/13/00 to inject $1 billion more into AIDA over next 2 years.
- Total federal farm income safety net spending is forecast to be $2.2 billion over next two years-$3.6 billion including provincial funds.

Table 3. Comparison of NISA, FARRM, and IRMA Accounts.

Policy Attributes	NISA	FARRM	IRMA
Farmer Deposit Maximums/Minimums	Max 20% ENS Eligible Net Sales/yr	Max 20% Net Farm Income/yr	Minimum 2% Gross Income/yr 1040 Schedule F
Maximum Account Balance	150% up to 5 year average Eligible Net Sales	None	150% of 3 year average Gross Income
Farmer Deposits Pretax/After Tax?	After Tax Income	Pretax Income	Pretax Income
Government Matching Deposit Contribution	Match $ for $ up to 3% ENS ($7,500/yr Maximum)	None	Crop Insurance Subsidy Equivalent Plus CAT Coverage
Interest Rate Bonus paid by Government	Additional 3 % on farmer deposits	None	None
Government Match Taxable?	After withdrawal	Not Applicable	After withdrawal
Interest Earnings Taxable?	After withdrawal	Annually	After withdrawal
Farmer Deposit Withdrawal Taxable?	None/Taxes paid before deposit	After Withdrawal	After Withdrawal
Withdrawal Triggers and time limits?	Gross Margin less than 100% of up to 5 year average; or Net Income below $20,000 for individual or $35,000 for family	Farmer Option; Rolling 5 year time limit on each year's deposits.	Current year Gross Income less than 80% of 3 year average

Additional Attributes	NISA	FARRM	IRMA
Advanced Withdrawals	Yes	Not Applicable; Farmer Option	None Described
Use of estimated withdrawal for Farmer Deposit	Yes	Not Applicable; Farmer Option	None Described
Limits on Insurance Coverage	None	None	Farmer allowed to purchase only non subsidized insurance
Unused Match Carried Forward	Allocation carried forward up to 5 years	Not Applicable	None Described
Voluntary Close Out Options	Yes, Lump sum or 5 year installments	Yes, if less than 5 years	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	10% penalty if each year's deposits are not withdrawn in 5 years.	Leave farming for non-farm employment; retirement; or bankruptcy
Differential tax rate bias for high income farmers	No, Farmer deposits from after tax income	Yes, Greater incentive to save for higher tax rates	Yes, Greater incentive to save for higher tax rates

X. Summary Comparisons of Incentives for Saving.

1. Income stabilization potential of FARRM concept is of limited benefit if weather cycles are normally 20 years and livestock cycles are longer than five.

2. U.S. farmers already have cash accounting and income averaging provisions in the tax code, therefore FARRM accounts may be of marginal benefit.

3. If a significantly stronger farm safety net is to be achieved via savings concepts, policy makers must consider more substantial options like NISA or IRMA.

4. Should those who self-insure by saving for bad times receive level playing field subsidies compared to those who receive subsidized crop insurance?

5. Should higher income farmers receive greater tax incentives to save for bad times?

XI. Summary Impacts of Incentives for Saving for Bad Times

1. Not a production cost like insurance premiums. Adds asset and loan collateral to Balance Sheet. Diversifies farmer investment portfolio.

2. All commodities including livestock, forestry, and specialty crops can benefit.

3. Govt. expenditures are more stable and predictable. Reduces/but does not eliminate Disaster Program need.

4. Counter-cyclical payment eliminates high payments in good years. Farm withdrawals only made in poor years.

5. Income stabilization capability grows over time.

6. Consistent with decoupling farm programs from planting decisions to maintain flexibility.

7. Consistent with market-oriented farm policy and improving Farm Safety net..

8. Perhaps more consistent with WTO rules.

9. Deposits Increase Rural Bank Loan Capacity and Economic Development Capacity of Rural Community.

XII. How does NISA/IRMA Compare to Other Selected Policy Alternatives with respect to Counter-Cyclical Payments and Planting Flexibility?

Option 1: Use AMTA payments to Increase Loan Rate for Loan Deficiency Payments and Marketing Loan Gains.

- Makes payments more counter-cyclical within current farm program framework.

- Reduces planting flexibility to degree that payments become more linked to specific program commodities in current year enterprise mix.

- Increases domestic incentive to produce more while forcing adjustment on to rest of world.

- Continues to compensate farmers for good weather and penalize farmers for bad weather.

Option 2. Reinstate Farmer-Owned Grain Reserves.

- Reduces planting flexibility to degree that access to the reserve is beneficial and linked to specific program commodities in farmer's enterprise mix for the current year.

- Counter-cyclical? Depends on conditions in 3 years and/or whether authority for extension is provided if poor economic conditions in 3 years.

- Increases market price of current year and provides incentive to produce more abroad as U.S. grain is withdrawn from market.

- Reduces market prices within 3 years as grain reserves re-enter market.

- Compensates farmers for good weather and penalizes farmers for bad weather.

Option 3. Expand Conservation Reserve Program and/or Conservation/ Environmental Amenity Payments during economic downturns.

- Total Planting Flexibility: payments decoupled from current year enterprise mix.
- Payments become more counter-cyclical to the degree that CRP expansion is triggered by economic downturn criteria.
- Policy issue regarding supply control implications.
- Differential impacts for livestock and forestry crops.

Option 4: Revenue Loss Payments when the national (state or county average) gross revenue per acre for the current year falls below a set percentage of the 5-year national (state or county average) gross revenue for the crop.

- Enhances counter-cyclical nature of farm program payments.
- Reduces Planting Flexibility if payments are made only for specific program commodities because payments become linked to the farmer's enterprise mix decisions for the current year. Planting Flexibility is retained only if Revenue Loss Payments are based on proxy enterprise mix, such as county, state or national average crop mix which decouples payments from planting decisions.
- Solves problem of rewarding for good weather and penalizing for poor weather.
- Payments to individual farmers are less reflective of actual losses as proxy loss and enterprise mix parameters become more removed from individual farm conditions.

Option 5. Government Purchased Insurance

- Enhances counter-cyclical nature of payments.
- Planting Flexibility may be reduced to degree that access and availability of insurance products are related to specific commodities in current enterprise mix.
- As premium subsidies increase, production is encouraged in more marginal areas.
- (CARD suggests using county average yields to reduce adverse selection, but that also reduces incentives for risk management among good producers as well.)

Option 6. NISA/IRMA Accounts.

- Counter-cyclical payments by design of withdrawal triggers.
- Provides total flexibility in planting decisions because benefits decoupled from current year enterprise mix.
- Payments are based on whole farm gross(net) farm revenues (size) up to policy imposed limits.
- Provides safety net for livestock, forestry and specialty crops that presently don’t have access to products in the insurance market.
- As structural change occurs, contract agriculture will likely increase and identification of comparable market prices will become more difficult. Safety net policies using gross or net income calculations (schedule F) become more viable compared to policies that rely on identification of reliable price and production information for specific commodities.