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THE DISTRIBUTION OF INCOME AND WEALTH
OF FARM OPERATOR HOUSEHOLDS

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The Distribution of Income and Wealth of Farm Operator Households

Because of the relatively low incomes of people associated with farming in the past, income maintenance has been a major focus of farm policy. The average money income of families earning farm self-employment income in 1983 was 93 percent of the average money income of other U.S. families (USDC). However, an average income of farm households has lost much of its meaning because it masks a great deal of variation. Compared to the past, farm households represent a heterogeneous population, presenting a new challenge to policymakers concerned about framing income maintenance policies. The current farm bill debate began in 1984 amidst piecemeal information on increased bankruptcies and general financial stress of farms. Analysis of the financial leverage and cash flow positions of farm businesses has since been forthcoming (Johnson, et al.). However, information on the financial well-being of those households associated with farming has remained limited. The purpose of this paper is to describe the financial well-being of farm operator households by measuring their size distribution of personal income and farm equity in 1984. The contribution of each source of income to the total inequality of incomes is also analyzed.

Theoretical Considerations

The theory of the functional distribution of income to factors is well developed, but economists engaged with describing and explaining the size distribution of income for individuals or households generally lament the lack of a single comprehensive theory to explain income distribution (Sohota). Many partial theories exist which highlight one or a few of the relevant variables associated with the lognormal distribution of incomes first described by Pareto in 1897. The ability school of income distribution theories, which

predates Pareto's empirical work, postulates that income is a function of innate abilities, and that both are normally distributed. Since the time of Pareto, the ability theory has been expanded to include variables that interact with ability to produce the observed lognormal distribution.

Other major factors featured in theories of the size distribution of income include: chance, the age structure of the population, individual choice, human capital, and wealth inheritance. The human capital-based theory currently dominates these theories. Its basic premise is that the distribution of acquired human capital, mainly educational attainment and on-the-job training, determine the distribution of earning capacity and income. Recently, Huffman has emphasized the importance of the ability to adapt to exogenous market forces as a relevant concept of human capital for farm operators. Acquisition of human capital is viewed as the result of individual optimizing behavior which is based on calculations of the present value of alternative streams of income. As such, it treats only the supply side. The life-cycle and inheritance theories highlight the importance of nonhuman capital as accumulated through one's lifetime and intergenerationally, respectively.

For any particular period of time, such as a year, the size distribution of income will depend on factors exogenous to operator characteristics. Farming is an occupation whose earnings are sensitive to market forces and, hence, volatile from year to year. Farmers generally expect to have wide swings in their income on an annual basis. The year 1984, the year in which this analysis is based, was the best year of the 1980s to date in terms of net farm and net cash income; but the value of farmland continued the decline begun in 1982.

Measurement of the Size Distribution of Income

The purpose of measuring the size distribution of income is to determine how total income earned by a specified population is distributed among members

of that population. The most frequently used approach, and that used here, is to report the percentage distribution of income recipient units in each total income class. Also reported is an overall measure of income inequality, the Gini index, which is based on the concept of the Lorenz curve. The Lorenz curve is a special case of concentration curves which plots the relationship between the cumulative percent of total income corresponding to the cumulative percent of the population when individual units are ranked in ascending order of their income. The geometric interpretation of the Gini index is the area between the Lorenz curve and a diagonal which represents perfect equality of income as a proportion of the total area under the Lorenz curve of perfect equality. If income is distributed perfectly equally, the Lorenz curve will coincide with the diagonal and the Gini index equals 0. Similarly, if income is distributed perfectly unequally, the Gini index equals 1.

The Gini index has the desirable properties that (1) it is invariant to proportional changes in income and (2) a transfer of income from an individual unit with a higher income level to an individual unit at a lower level of income decreases the measure of income inequality. Moreover, since it is the most widely used measure of income inequality, comparisons of inequality among distributions may be facilitated.

This paper also presents the results of an application of a new approach to measuring the Gini index which permits indexes to be calculated for each source of income (Lerman and Yitzhaki). This approach is insensitive to the order in which the contribution from each source is measured and it allows calculation of indexes for more than two sources of income, unlike previous techniques generally used for measuring the contribution to total inequality from various sources of income. Lerman and Yitzhaki first show how the conventional formula for the absolute Gini index, A , can be expressed as twice the

covariance between total income y_t , and its cumulative distribution function, $F(y_t)$:

$$(1) \quad A = 2 \text{ cov } (y_t, F (y_t)).$$

The relative Gini, a more useful measure of inequality and the one commonly referred to as the Gini index, results from dividing (1) by the mean of y_t . For each income source, y_i , the Gini can be expressed as:

$$(2) \quad G_{y_i} = 2 \text{ cov } (y_i, F (y_i)) / \bar{y}_i.$$

The contribution of each source to total inequality is calculated as the product of the Gini, the share of total income, and the Gini correlation for each y_i . 1/ The total Gini can then be expressed as the summation over all source's contribution to total inequality.

Source of Data and Definition of Income

Data for this study were obtained from a national farm operator survey to obtain information on the amount and sources of production expenses, revenues from farm marketings and other farm-related earnings, off-farm earnings, and selected debt and asset data for the farm business. The 1984 Farm Costs and Returns Survey is a personally enumerated probability-based survey. The sample consists both of farmers chosen from a list of known operators compiled by the Statistical Reporting Service (USDA), and segments of rural land in which all residents were interviewed to determine if they qualified as farm operators. Of the 23,386 rural residents contacted, 72.8 percent participated in the survey. Since a probability sample of farms was drawn in the survey, each respondent represents a number of other farms of a similar size and type.

Total income of farm operator households is defined as income from the farm operation and income of the farm operator household from off-farm sources. 2/

Three sources of farm income are defined: business farm income, household farm income, and income from government farm programs. Business farm income is income from the production of agricultural commodities. It includes all cash income, net of cash expenses, depreciation, and in-kind benefits to hired labor. Household farm income is income the household earns directly from the business and includes an imputed rental value for farm dwellings, the value of agricultural commodities produced and consumed on the farm, and wages and fringe benefits the business pays to the operator household for its labor. Government farm program payments represent only the direct contribution to farm income. Government program benefits tend to be capitalized into asset values, as well, resulting in capital gains. Farm capital gains (or losses, for 1984) are not included in our definition of farm income although they are known to make a significant contribution to the well-being of operator households. Four sources of off-farm income are defined: nonfarm wage and salary income, wage and salary income earned from work on other farms, business and professional income, and income from all other sources. The measure of equity used in this paper refers only to farm business holdings and excludes assets of the farm household and all financial assets.

The Distribution of Total Household Income

A popular concept for distributing the total income of operator households is based on the value of agricultural sales class categories (USDA). These sales class distributions are often used as proxies for the size distribution of income in agriculture. Sales classes, like acreage classes, are more appropriately viewed as measures of farm size. Survey data indicate that 42 percent of farms have less than \$10,000 in sales (table 1). These smaller farms account for only 2 percent of sales but have 7 percent of cash expenses and

about a fifth of the estimated depreciation expense. This leaves these smaller farms with a negative share of estimated net farm income. Only farms with sales over \$100,000 have a sales share in excess of their portion of cash expenses. In contrast to the distribution of earnings from the production and sale of commodities, household related income, such as the consumption of home-produced commodities, is more equally distributed. The more even distribution of household farm income and the uneven distribution of off-farm income towards the smaller farms partially offsets the greater concentration of farm business earnings and government payments on the larger farms.

Equating sales classes with income classes can be misleading because of the wide dispersion in income within each sales class (table 2). As the sales classes increase in value the percent of operators in the highest income classes and the average income tend to increase. However, the lowest sales class category actually had the lowest percent of operator households with negative total incomes. Eleven percent of that lowest sales class category also had total incomes over \$40,000. The largest sales class category more closely approaches the positive relationship generally expected between sales and income classes, with one exception. Seventeen percent of operator households in the largest sales class category have negative total incomes.

The survey data indicate that the average farm operator household's total income from farm and off-farm sources is \$26,633 (table 2). Fifteen percent of all farm operator households have negative total incomes and 11 percent have incomes in excess of \$60,000. The Gini index of the distribution of total income for U.S. operator households is .60. This compares with a 1966 Gini index of .48 reported for farm operator incomes by Carlin and Reinsel, indicating that total income from all sources is less equally distributed. ^{3/} This result

appears reasonable given the increased concentration of production and sales that has occurred in the sector during the past 20 years.

Incomes are more unequally distributed for operator households whose operators' major occupation is farming than other occupations (Gini index = .63 vs. .55). The average household income of operators whose major occupation is farming is \$24,567, compared to \$30,186 for other operators, and a greater proportion of these households have negative total incomes. However, 13 percent of operators who spend more of their time farming than any other occupation have incomes above \$60,000, compared to 7 percent of operators with farming as a secondary occupation.

Farm Equity

The survey data indicate an average value of farm assets of \$324,044 and an average farm debt of \$70,887 (table 3). The negative income class has the highest debt-to-asset ratio of .31, compared to the average of .22. Income is more equally distributed within farm equity categories than across the sector. With the exception of those with negative incomes, as farm net worth increases the distribution of total incomes shifts to the right and average incomes increase. Such a finding is not surprising in light of the greater nonhuman to human capital ratio required to successfully earn a living in farming and underscores the importance of the life-cycle and inheritance theories for explaining the income distribution of operator households. In spite of the high percent of operator households with negative total incomes (27 percent) in the highest equity class, the average total income is \$147,617. Owing to the concentration of households in the highest income category, this farm equity class also has the most equally distributed income (Gini index = .45). As farm equity increases, so does the proportion of operator households who have negative total incomes.

Distribution of Sources of Income

The increasing dependence of operator households on off-farm sources of income has been documented for some time (Lee, Reinsel, USDA). Of the average income of operator households as shown in table 4, 61 percent originates from sources other than the farm operated, mostly from off-farm wage and salary jobs (46 percent). Such a dependence on off-farm sources of income supports the relevance of the human capital theory for explaining income distribution for operator households. Most of the 39 percent of the income earned on the farm flows directly from the farm business to the farm household as rental value of the farm dwelling for resident operators, food produced and consumed on the farm, and wages and benefits paid to operator households by the farm business for their labor on the farm. Including government farm program benefits, the survey data indicate that net income from the production of agricultural commodities accounts for only 10 percent of the average farm operator household's total income.

Two clear trends emerge from the distribution of sources of income to total income classes. (1) As total income increases, income from both farm and off-farm sources increases. (2) As total income increases, the percent of income from farm sources increases and the percent of income from off-farm sources decreases. Only the two largest income classes earn half or more of their income from farm sources; and most of their farm earnings are from the production of agricultural commodities. Those households with negative total income lost on average \$41,988 in farming. They also received an average of \$2,547 in government payments, second only to households in the highest income class of \$60,000 and over. Households with negative incomes also have the lowest average income from off-farm sources.

The Lerman-Yitzhaki approach is used to estimate the contribution of each income source to the income inequality of farm operator households (table 5). ^{4/} Gini indexes by source, as defined in (2) above, are expected to be higher than the overall index because, with the exception of business farm income, many households do not earn any income for a particular source. For example, the majority of households did not earn government payment income nor each of the off-farm sources of income and this is reflected in its high Gini indexes. In contrast, all of the households had business farm income and the high Gini index of .91 is largely a reflection of the wide variation in earnings. Household farm income is the most equally distributed of all income sources resulting from the high proportion of households earning this source of income as well as from its relatively even distribution to these households which do earn this source of income.

The second column in table 5 presents the contribution of the source to total inequality. This measure is a function of the source's Gini index and contribution to total income and the Gini correlation between the source of income and total income. The higher the value of these factors, the greater will be the contribution of that income source to total inequality. The sum of these statistics by source, equals the overall Gini index. In order to determine the contribution of each of these sources to the overall Gini index, the third column presents the proportion of inequality attributed to the source of income. This is given by the ratio of each source's contribution to total inequality to the total Gini index. Business farm income contributes the largest proportion to the income inequality of operator households (79 percent). Household farm income contributes only 5 percent and government farm programs contribute only 3 percent to the overall income inequality. Total off-farm income contributes 13 percent to the total Gini index.

The fourth column in table 5 shows the income inequality of each source of income relative to its share of total income. Relative inequality is defined to be the ratio of the proportional contribution to the share of total income. Unlike off-farm income, farm income contributes a greater proportion of the inequality among households than the proportion it contributes to total incomes of households.

Information related to the relative inequality is presented in the final column of table 5. The difference between the proportional contribution to overall inequality and the share of total income for each source is interpreted as the relative marginal effect upon the overall income inequality of proportional changes in each household's income source. The direction of this relationship indicates the effect on the margin of an increase of this source of income on overall inequality. Because of the relatively large contribution made by business farm income to overall inequality, the negative sign indicates that an increase in that source of income would actually increase the income inequality on the margin for farm operator households. Like off-farm income, increases in government farm payments and household farm income would decrease income inequality on the margin. It is not surprising that as a result of the dominating contribution business farm income makes to overall inequality, an increase in any of the other sources of income relative to business farm income will tend to decrease the relative marginal inequality.

The result pertaining to government payments merits elaboration. First, we know from table 1 that a positive relationship exists between average government payments and farm size because many programs are production-based. Secondly, because government payments are not proportionately distributed, they have a high Gini index and make a positive contribution to the overall income

inequality. Thirdly, that contribution is small for two reasons. (1) They represent a small share of total income. (2) The Gini correlation, which is the ratio of the covariance of payments and the rank of total income to the covariance of payments and the rank of payments, is low. The relatively low value of the Gini correlation of government payments can be explained by the relationship between size of total income and government payments (table 4). Government payments contribute a larger share to total incomes of households in the two lowest income classes. For the other classes, the proportion is generally constant. Households in the negative total income class receive average payments second only to the highest total income class. This negative total income class includes a significant portion of the high production farms (table 2). The fourth result relating to government payments is that the contribution of payments to inequality relative to the total inequality is smaller than its share of total income. The implication is that if government payments were to increase, total inequality would decrease. This may be a short-run relationship, however, to the extent that there is a higher proportion of large farms in the negative total income class and that business farm income is more unequally distributed during the survey year than during other less stressful periods for the agricultural sector. Finally, it is important to emphasize that this analysis includes only the direct effect from government payments.

Conclusions

Policymakers have been under pressure to alleviate the current financial stress on farm businesses through government farm programs. A related concern focuses on the well-being of those households associated with the farm businesses. This paper shows that group, defined as operator households, to be a very heterogeneous group, particularly in terms of their financial well-being, their

output of agricultural commodities, and their dependence on the farm for support. Because government farm programs are generally production-based, they will have the greatest effect on the larger farms. The average income of households associated with the largest farms (sales greater than \$100,000) is well-above the national average. However, 17 percent of these households have negative total incomes and at least another 6 percent are below the official poverty line. To the extent that these low incomes are not a short-run experience, adjustments are imminent. The households associated with farms that are traditionally viewed as family farms (sales between \$40,000 and \$100,000), contribute their proportionate share to total production but have average incomes comparable to the households associated with smaller farms, which contribute relatively little to total production. However, unlike those on smaller farms, households associated with the mid-sized farms have proportionately less off-farm income. For this reason, farm policies similar to those of recent years will likely have a greater impact on the total incomes of households associated with the mid-sized farms. Farms with sales less than \$40,000 represent two-thirds of all farms. But, they contribute only 10 percent of the total production and households associated with these farms earn more than three-fourths of the off-farm income. Changes in farm policy will have little effect on the incomes of these households. Off-farm employment opportunities and relevant rural development policies will have the greatest effect on the incomes of households associated with small farms.

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Footnotes

1/ Lerman and Yitzhaki's straightforward application of this definition is to substitute the covariance term, $\text{cov}(y_i, F(y_i))$, with the covariance of the income source and the rank of the income source (in ascending order) divided by n . This results because the rank divided by n is a representation for $F(y_i)$. The Gini correlation of y_i is defined to be the ratio of the covariance of the source of income with the rank of total income to the covariance of the source of income to its rank.

2/ An assumption was made that all farm income is earned by the farm operator household. This is untenable in some cases, such as for corporations. The definition of total household income differs from the official USDA concept because the value of the change in inventories is omitted. In 1984, the value of the inventory change is estimated to be approximately \$8 billion. Aside from the definitional difference, estimates in this paper will not correspond to the official estimates because of differences in sources of data. Estimates of total operator household income are also not comparable to Current Population Survey estimates, mainly because nonmoney income and expenses are included in the estimates presented here.

3/ Carlin and Riensel did not include nonmoney income in their definition of household income. When the income definition for the data used in this study excludes nonmoney income the differential in Gini indexes is somewhat larger, resulting from the relatively more even distribution of nonmoney income. The Gini indexes for all U.S. families in 1966 and 1983, respectively, were .35 and .38 (USDC). The Gini indexes reported throughout the paper are calculated with the negative incomes recoded to zero, to avoid the statistical problems caused by the large number of negative incomes. This will have the effect of underestimating the degree of inequality. The Carlin and Riensel Gini index was calculated by defining the first income group to be large enough to yield

a positive average income. Such an approach with the 1984 data required that the first group contain more than half the sample and yielded a Gini index of .73.

4/ The analysis of the distribution by source is based on unweighted data. The overall Gini index with weighted data is .60 compared to the overall Gini index with unweighted data of .59.

Table 1. Distribution of farm numbers and sources of income, by value of agricultural sales class, 1984.

VARIABLE	Value of Agricultural Sales Class				
	\$9,999	\$10,000	\$40,000	\$100,000	\$500,000
	and	to	to	to	and
	Less	\$39,999	\$99,999	\$499,999	Over
	PERCENT				
Number of Farms	42	23	17	16	1
Sales	2	8	17	47	26
Farm Related Income	20	16	20	30	14
Net CCC Loans	4	12	26	50	9
Cash Expenses	7	10	17	43	23
Noncash Expenses	22	17	21	32	7
Business Farm Income	-432	-185	16	407	294
Government Payments	4	12	27	47	10
Dwelling Rental Value	38	21	17	21	4
Wages Paid Family	4	5	16	53	22
Benifits Paid Family	4	6	14	52	25
Home Consumption	37	21	19	21	2
Household Farm Income	32	18	17	27	7
Total Farm Income	-7	2	19	58	28
Off Farm Income	52	26	10	11	1
Total Household Income	29	17	14	29	12

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 2. Distribution of total income of farm operator households within each value of agricultural sales class, 1984.

Total Income Class	Value of Agricultural Sales Class						Total
	\$9,999	\$10,000	\$40,000	\$100,000	\$500,000		
	and Less	to \$39,999	to \$99,999	to \$499,999	and Over		
	Percent						
Negative Income	12	18	18	17	17		15
\$0 to \$9,999	25	19	11	6	1		18
\$10,000 to \$24,999	32	32	25	10	3		27
\$25,000 to 39,999	19	19	21	12	5		18
\$40,000 to 59,999	8	8	15	17	4		10
\$60,000 and Over	3	4	7	38	69		11
	Value						
N	713,376	393,383	294,909	267,806	24,465	1,693,940	
Average Total Income	\$18,305	\$19,032	\$20,679	\$48,955	\$219,091	\$26,633	
Gini Index	0.51	0.58	0.51	0.46	0.30	0.60	

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 3. Distribution of farm balance sheet variables and households by farm equity class, to total income class, 1984.

Financial Characteristic:	Total Income Class						Total		
	Negative	\$0	\$10,000	\$25,000	\$40,000	\$60,000	N	Average	Gini Index
	Income	to	to	to	to	and			
		\$9,999	\$24,999	\$39,999	\$59,999	Over			
	Percent								
Farm Balance Sheet									
Assets	22	10	17	14	11	26	1,493,940	\$324,044	-
Debt	32	8	13	11	9	27	1,493,940	\$ 70,887	-
Equity	20	11	18	15	11	26	1,493,940	\$253,157	-
Debt to Asset Ratio	31	17	17	10	19	22	1,493,940	22	-
Equity Class									
<\$100,000	14	24	33	18	7	4	656,609	\$ 17,615	.55
\$100,000-499,999	15	16	26	20	13	10	850,150	\$ 25,026	.54
\$500,000-999,999	20	7	12	15	14	32	129,301	\$ 47,760	.53
\$1,000,000-3,000,000	22	9	9	8	5	47	48,918	\$ 97,576	.50
>\$3,000,000	27	2	5	6	5	55	8,962	\$147,617	.45

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 4. Average income by income class and source of income, 1984

Table 4. Average Income by Income Class														
Source	Income Class													Total
	Negative Income	\$1 to \$9,999	\$10,000 to \$24,999	\$25,000 to \$39,999	\$40,000 to \$59,999	\$60,000 and Over								
	Average: % of total	Average: % of total	Average: % of total	Average: % of total	Average: % of total	Average: % of total					Average: % of total	Average: % of total		
Business Farm	-52416	139	-5039	-96	-1422	-8	2533	8	11501	24	77930	53	749	3
Household Farm	7911	-21	4960	95	5679	33	6945	22	9207	19	16743	11	7689	29
Government Farm Payments	2547	-7	565	11	877	5	1367	4	3325	5	7009	5	1962	7
Total Farm	-41933	111	486	9	5134	30	10816	34	23033	48	101683	69	10420	39
Wages and Salaries	1837	-5	1990	38	7452	43	14492	46	16979	35	10591	7	8216	31
Business and Professional	877	-2	722	14	1221	7	2423	8	3914	8	24163	16	4065	15
Wages from Other Farms	131	0	165	3	227	1	99	0	196	0	84	0	159	1
Other Off-Farm	1379	-4	1859	36	3173	18	3768	12	4141	9	11502	8	3772	14
Total Off-Farm	4274	-11	4737	91	12076	70	20782	66	25230	52	46340	31	16213	61
Total Household Income	-37714	100	5223	100	17209	100	31620	100	48269	100	148023	100	26633	100

Table 5. Contribution of sources of income to overall inequality.

Income Source	Gini index	Contribution to total inequality	Proportional contribution to inequality	Relative inequality	Relative marginal effect
Business Farm	0.91	0.47	0.79	1.48	0.26
Household Farm	0.60	0.03	0.05	0.25	-0.14
Government Payments	0.90	0.02	0.03	0.42	-0.05
Total Farm	0.66	0.52	0.87	1.08	0.06
Nonfarm Wage and Salary	0.84	0.02	0.03	0.37	-0.05
Wages from Other Farms	0.99	0.00	0.00	0.12	0.00
Business and Professional	0.97	0.03	0.05	0.99	0.00
Other Off-farm	0.90	0.03	0.05	0.70	-0.02
Total Off-Farm	0.76	0.07	0.13	0.64	-0.07

Source: 1984 Farm Costs and Returns Survey, USDA.