



## Farm Payment Limits: History and Observations

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Debate over limits on payments by farm safety net programs has become increasingly passionate. In the current 2012 Farm Bill debate, significant attempts likely will be made (1) to further tighten existing payment limits and (2) to implement limits on crop insurance. Therefore, this post discusses the history and several interrelated topics concerning farm payment limits. Please note, this discussion neither endorses nor opposes payment limits.

### Historical Background

To the author's knowledge, the first limit on payments by farm programs (\$10,000) date to the *Agricultural Adjustment Act of 1938*. Thus, farm payment limits are nearly as old as the farm safety net itself, which began in 1933. However, payment limits did not become a continuous part of farm bills until the *Agricultural Act of 1970*, which limited total government payments to \$55,000 per farmer per crop. Current limits on payments by individual farm programs are:

- \$40,000 on direct payments if a farmer does not participate in ACRE and a \$32,000 limit if a farmer participates in ACRE,
- \$65,000 on counter-cyclical payments, and
- \$73,000 on payments by ACRE (limit varies by farmer; this is the highest limit).

Means testing for farm programs, a type of payment limit, was added in the *Farm Security Act of 2002*. Means testing prohibits or reduces payments to an entity with a high enough income. Specifically, producers with adjusted gross income of over \$2.5 million, averaged over the previous 3 years, were ineligible for direct and counter-cyclical payments, marketing loan benefits, and conservation payments. However, an exception was granted if 75% or more of adjusted gross income was from farming, forestry, or agriculture. After lengthy debate, the means test was tightened to the following in the *Food, Conservation, and Energy Act of 2008*:

1. An entity with an adjusted gross farm income of over \$750,000, averaged over previous 3 years, is not eligible for direct payments.
2. An entity with average adjusted gross nonfarm income in excess of \$500,000 is not eligible for direct payments, as well as payments from the counter-cyclical, ACRE, marketing loan, noninsured

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crop assistance, milk income loss contract, or disaster assistance programs

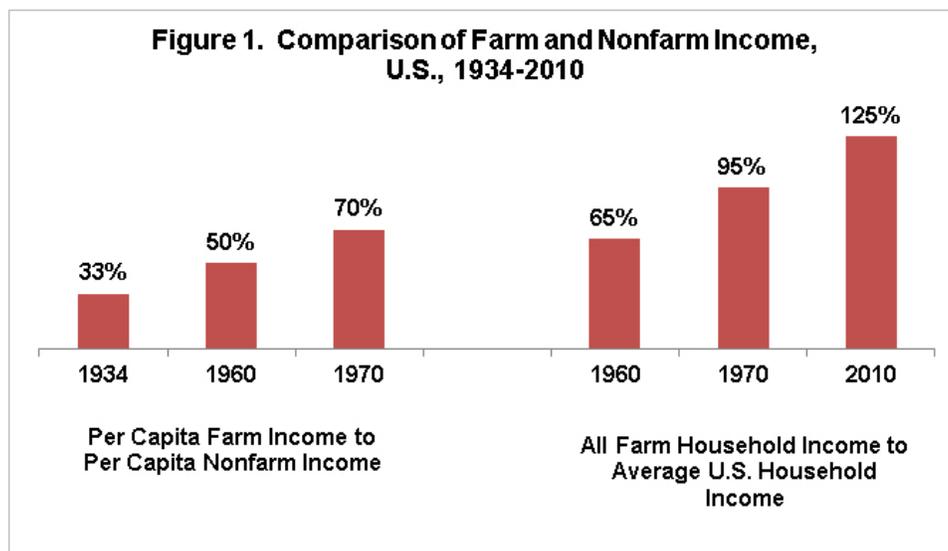
3. Producers with adjusted gross nonfarm income, averaged over 3 years, in excess of \$1 million are not eligible for conservation, supplemental agricultural disaster assistance, and agricultural-risk-management assistance unless 66.66% or more of total income was average adjusted gross farm income.

Two other aspects of payments limits also are important. First, limits are not usually attached to a farm or a farmer but to a payment entity. For example, spouses of farmers may be eligible for their own payment limit under the 2008 Farm Bill. Second, it is not uncommon for farm bills to exclude some farm programs from payment limits. For example, the current 2008 farm bill has no payment limit on marketing loans. However, the U.S. Senate voted 75 to 24 to accept an amendment to its 2012 Farm Bill that would limit marketing loan gains to \$75,000 per entity. The U.S. Senate also voted 66 to 33 to accept an amendment to its 2012 Farm Bill that would reduce the crop insurance subsidy for farmers with adjusted gross income of more than \$750,000.

### Why Interest in Payment Limits Has Increased?

It is not clear why payments limits became a continuing part of the farm bills with the 1970 Act, but one likely reason was the transformation from programs that established floors under prices to programs that made payments to farmers. This transformation began in the 1960s. A second likely reason reflects an ongoing historical trend that underpins much of the historical and contemporary debate over farm program payment limits.

One of the foundation reasons for enacting a farm safety net in 1933 was the poverty of U.S. farm families. In 1934, per capita income of the farm population was only 33% of the per capita income of the non-farm population (see Figure 1). However, due to technological change, migration out of farming, and the growth in nonfarm income earned by farm families; the income of farm families has improved notably. By 1970, per capita income of the farm population had reached 70% of the per capita income of the nonfarm population. Per capital income is no longer reported for the farm population. Instead the ratio of average farm household income to average U.S. household income is reported. This ratio is first available for 1960, when it was 65%. By 1970, the ratio had reach 94%. The ratio exceeded 100% in 1972 and has been consistently above 100% since 1996. For the latest year available, 2010, the ratio is 125%.



Debate occurs over whether these measures of farm well being are the most appropriate. One argument is that the appropriate comparison is between farm businesses and self employed Americans. Nevertheless, it is difficult to say that a different measure would alter the long run trend depicted by the above data. Also, it is important to remember that farm programs involve income transfers from taxpayers to farmers. Thus, comparison with average household income is at least one relevant perspective. In summary, the historical trend of increasing parity between farm and nonfarm income has prompted proponents of payment limits to ask whether it is fair that farms, in particular large farms, receive

government payments when their income is close to or above the national average for all households.

### **Entity Payment Limits vs. Per Unit Payment Limits**

Payment limits are usually thought of limits on payments to a payment entity. As noted above, entity payment limits come in the form of means tests and limits on payments by a specific program or a set of programs. However, a second type of payment limit exists: limits that reduce payment per unit of a commodity to less than 100%. For example, counter-cyclical and ACRE payments currently are made on 85%, not 100%, of eligible acres. Another example is that the highest coverage level for individual crop insurance is 85%.

Historically, entity payment limits have always attempted to limit payments to the largest farms. Because of their focus on only the largest farms, entity payment limits generally reduce the cost of farm programs by only a small amount. In other words, historically entity payment limits have been more about social fairness than cost savings. However, given the current U.S. federal budget deficit, entity payment limits may gain more appeal as a way to reduce the budgetary cost of farm programs.

In contrast, per unit output payment limits almost always seek to reduce the overall cost of a program. They can attain this goal because they affect all recipients of farm program payments.

While different in focus, the two types of payment limits do interact. In particular, reducing per unit payments reduces the probability that entity payment limits will be exceeded. Thus, for example, the U.S. might choose to address the debate over crop insurance subsidies for large farms by treating it as an associated outcome of reducing the insurance subsidy level for all farms in order to reduce the cost of farm safety net programs.

### **Design Considerations**

As with any program parameter, limits on payments from a program should be designed to be consistent with the objective and operation of the program. For example, the direct payment program is designed to make payments to farms. Thus, placing limits on payments to entities is consistent with the objective and operation of the direct payment program.

In contrast, limits on payments seem inconsistent when a program's objective is to help manage risk. Risk management programs will make large payments when a sizable shortfall in revenue, yield, and/or price occurs. Moreover, occurrence of such a shortfall is not known when planting decisions are made. To limit payments when they are most needed is inconsistent with the objective of helping to manage risk.

In the case of crop risk management programs, risk occurs on an acre planted to a crop. Given this observation, it would be more consistent to limit the number of acres eligible for a risk management program or crop insurance subsidy. Limiting eligible acres means that the farmer knows before planting what his/her risk exposure is, and thus can make appropriate management decisions both on the land eligible for the risk management program and on the land that exceeds the acreage limit. As a result, the farm's use of resources should be more efficient.

Putting a dollar limit on insurance subsidies is a more consistent policy decision than putting a dollar limit on insurance payments because the subsidy limit would be known before planting. Thus, a farmer can make managerial adjustments to efficiently use his/her resources. However, putting a dollar limits on insurance subsidies will discriminate against high value crops. The reason is that insurance subsidies are related to insurance payments, which in turn are related to the gross value per acre of a crop. Thus, limiting the dollar value of insurance subsidies may end up influencing planting decisions.

### **Summary**

The history of farm policy and underlying economic trends suggests that payment limits are likely to become an even more important topic of debate in farm bills. The only exception might be if farm family income deteriorates relative to non-farm family income. Given this situation, it is important that informed debate occur, particularly in regard to how to design payment limits to minimize negative impacts on the efficiency with which farmers use resources.

**Sources for Figure 1:**

(1) U.S. Department of Agriculture, Economic Research Service, "Economic Indicators of the Farm Sector: Income and Balance Sheet Statistics, 1983," ECIFS 3-3. (2) U.S. Department of Agriculture, Economic Research Service, "Farm Household Economics and Well-Being: Historical Data on Farm Operator Household Income," accessed June 20, 2012 at <http://www.ers.usda.gov/Briefing/WellBeing/Gallery/historic.htm>

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