CBO STAFF MEMORANDUM

FARM INCOME PROJECTIONS AND THEIR IMPLICATIONS FOR AGRICULTURE

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CONGRESSIONAL BUDGET OFFICE
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WASHINGTON, D.C. 20515

This staff memorandum is in response to a request from Senator Christopher S. Bond regarding the interpretation of certain statements contained in *The Outlook for Farm Commodity Program Spending, Fiscal Years 1990-1995.*

The memorandum was prepared by David Trechter and Roger Hitchner of the Natural Resources and Commerce Division.

A statement that appeared in a recent Congressional Budget Office publication, *The Outlook for Farm Commodity Program Spending, Fiscal Years 1990-1995*, has caused some comment and controversy. The paragraph in question appears on page xvii of the summary and reads as follows:

> "If real incomes for agricultural producers were to fall by the projected amounts, a substantial decline in the number of farms could result. Average real net farm income per farm in 1988 was $16,364. With a projected real net farm income of $28.3 billion for the sector in 1995, maintaining the 1988 level of average net farm income would require that nearly 500,000 farms leave the sector. Such an exodus would be substantially greater than that observed during the 1980s, a period widely considered to have been financially the worst one for farmers since World War II. However, most of the decline in farm income is expected to be offset by increases in off-farm income. This is a continuation of a long-term trend in which an ever greater proportion of the farm population has become increasingly dependent upon off-farm employment for their financial well-being. But even with higher off-farm income, the total income of farm families declines in real terms during the projection period."

The Congressional Budget Office is not predicting that there will be a net loss of 500,000 farms between 1988 and 1995. The decision to leave farming is a very complex one and CBO does not attempt to predict the number of farmers that will leave the sector. The figure was used strictly for illustrative purposes and likely overstates the actual decline by a substantial amount. To say that the sector's real income would fall by several billion dollars by 1995 gives little sense of what this might mean for individuals in the agricultural sector. Holding real net farm income per farm constant and calculating the number of farms that could be maintained at the projected 1995 level of aggregate net farm income is one way of indicating some of the human dimensions of the baseline figures.

The income projections do suggest that the financial well-being of the sector will decline in real terms. A decline in farm income means that either per farm income will fall, there will be fewer farms, or, as is more likely, there will be both fewer farms and lower per farm income. The calculation that leads to the farm exit figure holds farm income constant and, hence, exaggerates the impact on farm numbers since some of any decline in sectoral income would likely result in lower per farm income.

If farm incomes per farm do fall, several different consequences could be anticipated. One consequence might be some belt tightening. Current conditions in agriculture suggest that farmers are in a relatively good position to survive a drop in income. One beneficial result of the difficult financial period of the mid-1980s was that farm debt declined from a peak of nearly $200 billion in 1982 to less than $140 billion by 1988. Lower debt loads, restructured loans, and lower interest rates all have contributed to the increased financial strength of the sector. In addition, net farm income in 1987 and 1988 was relatively high, providing farmers with some financial cushion.

A second consequence could be, as noted in the paragraph from the report cited above, an increased reliance on off-farm income. For many farms, particularly those in the smaller sales classes, the primary source of income is the off-farm job. For these farmers, declines in farm income would have a relatively minor impact on the family's financial situation and would be unlikely to cause them to leave agriculture. For others, a greater commitment to off-farm earnings would entail a significant reorganization of their economic activities. For example, as real net farm income per farm declines, some full-time farmers could sell some of their farm assets but remain in farming, *albeit* at a reduced level.

Finally, there will be fewer farms by 1995, though the size of the net decline in farm numbers is far from certain. Farm numbers declined nearly continuously from 1945 to 1988 at an average rate of 1.3 percent per year. A continuation of this trend would result in a reduction of about 200,000 farms by 1995. This is slightly less than the decline implied by holding CBO's projected farm family income per farm constant at the 1988 level--259,000 farms (farm family income equals net farm income plus off-farm income). Farm family income is probably a better indicator of the likelihood of farm exit than is net farm income.

While the trend toward fewer farms may be unfortunate from some perspectives, it has contributed to the economic well-being of those remaining in farming. The departure of some farms has allowed remaining farms to increase in size. With larger farms, farmers have been able to realize the full benefit of technological advances and improve their incomes. Real aggregate net farm income was nearly the same in 1988 as in 1960 but the farm population declined by nearly 70 percent, meaning real net farm income per capita more than tripled. If off-farm earnings are included, farm income per capita nearly quadrupled during this period. In comparison, real personal income per capita in the United States, a measure of the income received by households before taxes, did not quite double during this same period.