Farm & Rural Communities

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Status Report

Small Farms in the U.S.

About 94 percent of the Nation's farms are small, with gross sales under $250,000. Three-fourths are very small, with sales under $50,000. Despite the continued predominance of family farms in the U.S. agricultural sector, the number of farms continues to decline and ownership and control of production has become increasingly concentrated. In 1995, approximately 6 percent of U.S. farms operated 28 percent of the land in farms. Two percent of farms accounted for 40 percent of sales, and 6 percent accounted for nearly 60 percent of the value of U.S. agricultural production.

The issue of concentration in U.S. agriculture arose during investigations by the USDA Civil Rights Action Team (CRAT) in January 1997 (see preceding article). Questions about the adequacy of Federal programs and service to small farmers led to the appointment by the Secretary of Agriculture of a commission to investigate the needs of U.S. small farms—the National Commission on Small Farms. The results of the Commission's work are embodied in 146 recommendations presented in its January 1998 report, *A Time to Act.*

USDA already has a number of programs targeted or accessible to small farmers. For example, the Office for Small-Scale Agriculture (OSSA) provides national leadership and coordination of activities that respond to the needs of small-scale farmers. Ongoing initiatives in which OSSA is involved include a small farm program at the University of California-Davis that concentrates on alternative marketing, specialty production and enterprises, getting started in farming, and the needs of small-scale, under-represented farm groups.

The Commission recommended a number of additional actions, including implementing a small farm research initiative; recommitting USDA as the "lender of last resort"; developing farmer-owned, value-added cooperatives and farm-based businesses; investigating illegal or discriminatory practices in the marketplace; and promoting and fostering local and regional food systems featuring farmers' markets, community gardens, community-supported agriculture, and direct marketing to school lunch programs. The Commission also called for forming farmer networks and mentoring programs for small farmers; establishing an interagency Beginning Farmer Initiative; developing projects for small farms using sustainable farming practices; dedicating USDA budget resources to strengthen the competitive position of small farms; and ensuring just and humane working conditions for all people engaged in production agriculture.

At the request of the Commission, USDA's Economic Research Service (ERS) provided reports on topics ranging from the economic and demographic situation of small farms and farm operator households to credit and insurance needs of small farms to the effects of changes in marketing structures and government programs on small farms.

Well-Being of Farm Operator Households

Farm household income—cash income from all sources available to the household before taxes, but after calculating depreciation—is on par with that of the average U.S. household. Estimates based on the 1995 Agricultural Resources Management Survey (ARMS) puts average farm operator household income at $44,392, compared with $44,938 for the average U.S. household. However, the distribution of income across operator households is more uneven than for all U.S. households.

To generate cash income close to that of all U.S. households, farms need to generate sales in the upper end of the small farm category. Operators in this category ($100,000-$249,999 in sales) overwhelmingly name farming as their major occupation. Still, households associated with these farms received substantial off-farm income—and generated total household income equivalent to the average for all U.S. households. Although small farm operators who named farming as their major occupation generated almost twice as much farm income as other small farms, their total household income was only 80 percent of the average U.S. household.

About 68 percent of farm operator households have income below the U.S. average, compared with just over 60 percent of all U.S. households. In part, this is due to the nature of farming, since in any given year a household may experience financial losses from the farming enterprise. Most U.S. households depend on wage earners who do not have these periodic losses.

The health of the rural economy is reflected in the fact that farm families can now earn off-farm income to mediate these farm losses—even on the largest farms,

Characteristics of Small Farms

U.S. farms are mostly family businesses that take the form of proprietorships, partnerships, and family corporations. Over 98 percent of all farms are family-operated and most farms are legally organized as sole proprietorships. Three percent of farms are legally organized as family corporations, which gives families tax and inheritance advantages not available to proprietorships and partnerships. Almost all of the very small farms (those with sales under $50,000) are sole proprietorships.

Small farms (sales of less than $250,000) accounted for 40 percent of the value of farm production in 1995—38 percent of the value of livestock and 44 percent of crops—with most of that production concentrated on farms with sales of $50,000-$249,999. Commodities with the highest share produced by small farms were tobacco (76 percent) and hay (69 percent). Over half the very small farms (with sales under $50,000) raised cattle, but these contributed only 17 percent of the total value of production of cattle in the U.S., since much beef is produced on large feedlots. Very small dairy farms had an average herd of 26 cows, while dairies with sales of $50,000-$249,999 averaged 100 cows. Beef cattle producers in the first group averaged 40 head of cattle, while the second group averaged 138. For hogs, the difference was even greater—about 50 for the first group compared with over 300 for the second.

Compared with only 11 percent of large farms, about 35 percent of all small farms specialized in beef cattle in 1995, which often have relatively flexible labor requirements that fit well with an off-farm job or retirement. Among very small farms, the proportion raising cattle was 41 percent. Most farms do not produce just one or two commodities, but specialization does become more likely as farms get larger, and also as farms get smaller. On small farms in general, approximately 70 percent indicated they produce more than one commodity and 20 percent produce four or more commodities. Among very-small farms, however, more than 40 percent produced only one commodity and 30 percent produced only two.

While 57 percent of small farms with sales of $50,000-$249,999 are in the Corn Belt, Lake States, and the Northern Plains, 46 percent of all small farms are located in the South. Very small farms are heavily concentrated in the South

Fixed costs are the largest group of expenses for the average small farm. These costs remain constant regardless of the level of production, so larger farms, because they have higher levels of production, cover these fixed costs and expenses with a smaller share of their gross income.

For farms with sales of $50,000-$99,999, the ratio of net cash income to gross cash income is 17 percent. For farms with sales of $100,000-$249,999, it is 21 percent, and for large farms (sales of $250,000 and over), the ratio is 22 percent, indicating that, on average, they will earn about 22 cents for every dollar of gross sales.

Net cash income reflects the current or short-term cash earnings available after paying all cash expenses, including interest, to distribute as income for living expenses, principal repayment on loans, income taxes, and reinvestment in the farm. It does not reflect the total cash available to farm families, because savings, farm wages paid to family members, and off-farm earnings are not included. Very small farms, those with gross sales under $50,000, have negative net cash farm income, on average—in fact, only 37 percent have positive, although low, net cash farm income. By necessity, these farmers depend on outside sources of income for their well-being. On average in 1995, very small farm businesses had a loss of $1,700. Other small farms (sales of $50,000-$249,999) had positive average net cash income of $23,000.

Net cash income varies across regions and commodity specialization. Farms in the Southeast and cattle operations—both of which have high concentrations of very small farms—tend to have lower net cash income than other farms.

Net farm income reflects long-term profitability of the farm business. Over time, it shows the farm's ability to survive as a viable business on its own. In 1995, the average net farm income for very-small farms was $510; on small farms with sales of $50,000-$249,999, it averaged $14,335. Other benefits from the farm, such as a preferred lifestyle or capital gains on the investment in farmland, likely compensate for the relatively poor financial performance of many small farms. Many operators of small farm businesses spend most of their work time in off-farm employment, making their households less dependent on farm income for their well-being than many households operating larger farms.

The makeup of vulnerable operations (high debt and negative income) varies by economic size and economic conditions during the year, but is concentrated among the larger small farms (with gross sales of $100,000 to $249,999). These farms accounted for 47 percent of the vulnerable operations in 1994, up from 35 percent the year before. This group includes a greater proportion of cash grains farms, and fertilizer costs continue to be the highest proportion of their total expenses.

the average operator household received 16 percent of its total household income from off-farm sources. In the past, when the rural economy did not provide many nonfarm employment opportunities, farm families often had substandard incomes. Even now, in areas where nonfarm employment opportunities are few, operator household income is lower, and households are more dependent on the earnings of the farm.

Limited-Resource Farms

By combining their farm and off-farm endeavors, many households continue to enjoy a farming lifestyle even though they have low farm income. However, some households have neither the human capital

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Characteristics of U.S. Small Farms Differ Markedly from Large Farms

	Small farms (sales less than $250,000)				
	Less than $50,000	$50,000-$249,999	All small farms	Farms with sales of $250,000 or more	All farms
Number of farms	1,531,760	413,431	1,945,190	122,810	2,068,000
Share of all farms (percent)	74.1	20.0	94.1	5.9	100.0
Value of production (percent)	9.5	31.3	40.8	59.2	100.0
			Dollars		
Average gross cash farm income	12,482	117,320	34,764	686,606	73,474
Livestock sales	4,671	45,910	13,436	272,625	28,828
Crop sales	3,662	52,117	13,960	331,236	32,802
Government payments	1,067	5,343	1,976	14,427	2,715
Other farm income	3,082	13,948	5,392	68,318	9,129
Average net cash farm income	-1,702	23,159	3,582	152,724	12,439
Average asset value	264,784	569,295	329,505	1,618,751	406,068
Commodity speciality			*Percent*		
Cash grain	12.6	38.4	18.1	30.4	18.8
Other field crops	19.3	7.7	16.8	10.7	16.4
High-value crops	6.0	8.7	6.6	13.4	7.0
Beef	40.4	14.0	34.8	11.1	33.4
Hogs	3.7	4.2	3.8	6.5	4.0
Dairy	1.1	17.5	4.6	14.6	5.2
Other livestock	16.8	9.6	15.3	13.3	15.2
Farms able to generate returns equivalent to average U.S. household income	7.6	38.8	14.2	70.5	17.6

Source: 1995 Agricultural Resources Management Survey.
Economic Research Service, USDA

to earn a successful living outside farming, nor the means to earn adequate income from farming. These *limited-resource* farm households—defined as having assets valued at less than $150,000, sales less than $100,000, and household income from all sources less than $20,000—accounted for 12 percent of all farms (255,000) in 1995. The Delta and Southeast regions had a proportionately greater number of limited-resource farms than other regions.

Everywhere except the Central region, average farm income for limited-resource households is negative. None of these households had sufficient off-farm income to offset their farm losses and bring household income above $20,000.

Minorities comprise approximately 7 percent of all farms, but are more likely to be in the limited-resource category. Approximately 13 percent of limited-resource operators are minorities, and just under 10 percent are female.

Operators of limited-resource farms tend to be older and have less formal education. While about a quarter of farm operators in all farm households are 65 or older, about half of the limited-resource farm operators are elderly—nearly 30 percent of limited-resource farm operators consider themselves retired but still farming. Slightly more than half of all limited-resource farm operators have less than a high school education, compared with only 22 percent of operators in all farm operator households.

Elderly operators are not likely to want either to expand an operation or to enter the nonfarm labor force. Since many limited-resource operators have less formal education than other workers, they are at a disadvantage as they compete with better-educated individuals in the nonfarm economy. While farming has not been generous to this group from a financial standpoint, alternatives may be limited, and living on a farm may allow them non-monetary benefits such as a farm dwelling, value of production consumed at home, and a preferred lifestyle.

Credit Availability Varies For Small Farms

Credit availability is key to the survival of small farms, and for helping young and beginning farmers succeed. The small farms definition, however, encompasses many different kinds of farms—including such diverse groups as limited-resource farms, retirement farms, residential/lifestyle farms, and farms where farming is the operator's main job—and their access to credit varies. For example, strong off-farm incomes, combined with low debt burdens, can make some very small farms attractive credit risks to commercial banks, which provide over half of their credit needs. For these small farm operators, access to credit appears not to be a problem.

Where credit availability is more likely to be a problem is among small and very small farmers with more limited resources. Available data do not provide information on the experiences these operators had applying for and obtaining loans, but information on debt held by these farms indicates that most had access to credit from a variety of sources. About half of small farms had debt outstanding, and most debt was supplied by banks. Data from the early 1990's indicate about one-fourth of small farm debt was supplied through USDA's Farm Service Agency (FSA) direct loans, with individuals supplying another 15 percent. In addition, trade credit provided by merchants and manufacturers has become an increasingly important method of financing loans under $50,000.

The Commission was concerned that banks may have disincentives to make loans to small farm operators, but although smaller loans are more costly to make and service, there is no indication that regulations are biased against beginning, young, or small farmers. Smaller loans can be handled with a simple demand note, and decisions may be based on credit scoring models that can be implemented quickly. For small farm operators who score well, credit availability will not likely be a problem. Commercial bank and Farm Credit System (FCS) loan data indicate that both these lenders make a substantial number of small loans.

Although traditional financial institutions like banks may not be a viable source of credit for operators who are judged less

Defining Small Farms

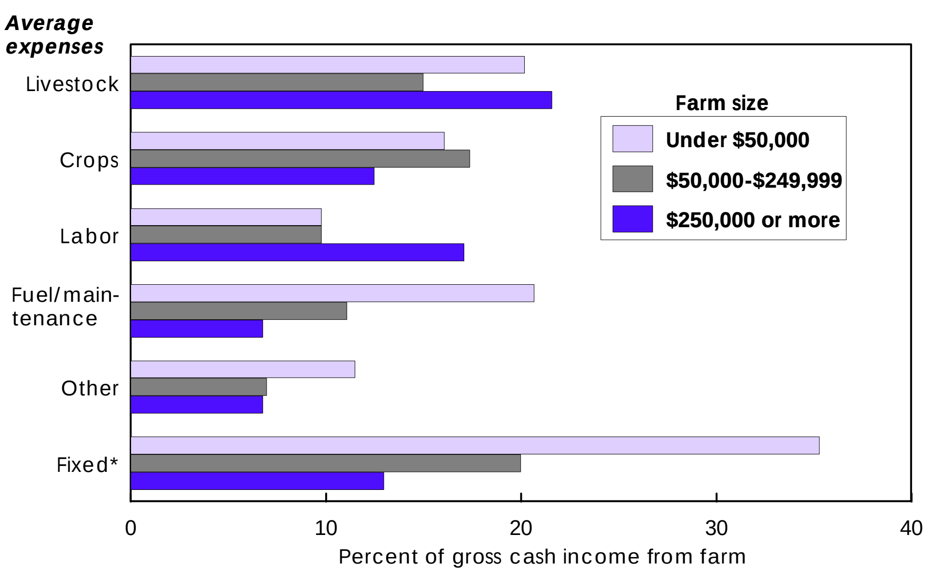
The "small" farms definition is problematic. A variety of small farm definitions have been used over time. In both 1977 and 1983, Congress legislated definitions of small farms that reflected existing conditions. The 1977 definition simply defined a small farm as any establishment with sales less than $20,000. Currently, $50,000 is more commonly used as the dividing point between very small and larger farms, reflecting inflation and growing farm productivity over the years. The 1983 definition focused on farm households with low income that depended on farming for their living. However, farm operator households now have an average income on a par with the U.S. average and many rely heavily on off-farm income.

Almost all farms are "family" farms in that they are run by individuals or their immediate families. The Small Business Administration considers farms small businesses when they have less than $500,000 in gross sales, except for cattle feedlots which can be as large as $1.5 million. If USDA followed this definition, 98 percent of farms would be included as "small" businesses.

Much ERS analysis defines "small" farms as those with sales under $50,000. The farm may be small because it is primarily a residence, or because it is being scaled down for retirement, or it may be a limited-resource operation without access to additional resources to grow. Most people with this size farm have other sources of income, but for some operators, the farm may represent a significant portion of household income or a significant source of employment.

The National Commission on Small Farms expanded the definition of small farm to include farms with gross sales of $50,000 to $250,000. The reasoning was that on most of these additional farms, day-to-day labor and management were provided by the farmers and/or the farm families, who own the product and own or lease the productive assets.

Fixed Costs Account for the Largest Proportion of Small Farm Expenses



*Fixed costs include real estate and property taxes, interest expenses, insurance premiums, and rent or lease payments.

Source: 1995 Agricultural Resouces Management Survey.

Economic Research Service, USDA

creditworthy, small farm loans are often made by input merchants and dealers. These businesses can offer attractive financing because they can process a loan application at a low cost at the time of purchase.

Statutes require the independent FCS lending programs to address the credit needs of young, beginning, and small farmers. Despite this targeting mandate, data collected by USDA indicate FCS lending tends to be concentrated among wealthier, older, and higher-income operators—only 4 percent of FCS debt was owed by farmers under 36, well below the 14-percent share of all farm debt owed by such farmers.

Impacts of Recent Legislation

Changes to Federal estate tax provisions made by the 1997 Taxpayer Relief Act (*AO* October 1997) will make it easier to transfer the family farm business across generations by reducing the likelihood that the farm or some of its assets would need to be sold to pay Federal estate taxes. About 2 percent of estates with farms that have sales less than $100,000, and for which farm assets are greater than nonfarm assets, owe Federal estate taxes. The increased unified credit, which sets the level of assets at which estate taxes become due, will exempt most small farms from both the payment of tax and the requirement to file an estate tax return. Some small farms will also benefit from the new family business exclusion and the lower interest rate on installment payments.

Many small farmers will also pay less Federal income tax as a result of new child tax credits, education incentives, health insurance deductions, and reduced capital gains taxes in the Taxpayer Relief Act. Small farmers will also benefit from added flexibility to deal with income fluctuations by income averaging and deferring the gain on certain weather-related livestock sales.

The Commission considered some of the implications of changes in Federal farm commodity programs for the health of

The report of the National Commission on Small Farms, *A Time to Act*, is available on the USDA home page at: http://www.reeusda.gov/agsys/ smallfarm/ncosf.htm

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small farms. The 1996 Farm Act redesigned the commodity program to move toward more market-based production in response to commodity prices. In 1995, 33 percent of farms participated in direct government commodity programs, receiving an average payment of $8,225. Not surprisingly, because Congress had designed the program to dispense payments based on production, larger farms received higher payments per farm—small farms with $100,000-$249,999 in sales made up 11 percent of participating farms and received 28 percent of payments, while large farms with $250,000 or more in sales made up 6 percent of participating farms and received 31 percent of payments. Even though larger farms received the greater share of payments, however, government payments were a larger share of gross income for the smaller farms.

Overall, farmers have seen and are likely to continue to see higher income under the 1996 Act than they would have received under previous legislation. Producers of some commodities, such as peanuts and dairy, however, will face lower returns under the farm act, which may mean problems for small producers.

The 1996 law potentially shifts more of the market risk from government to producers. Risk management through crop and revenue insurance, options, and other devices will become a more important part of successful farming. Some small farmers may lack access to information and capital required to respond to shifting market opportunities and to deal with price and market risk (*AO* May 1997).

According to data from the 1996 ARMS, of the over 2 million farms in the U.S., almost half a million purchased the Federal Crop Insurance Corporation's (FCIC) basic catastrophic coverage. Tiny farms (sales under $10,000) rarely were insured under FCIC, and less than one-third of farms with sales of $10,000-$49,999 indicated they purchased the insurance. Over half of operators whose farms had sales over $50,000 purchased the basic catastrophic coverage.

Marketing on Small Farms

The Commission identified effective markets and new marketing systems as key to the strengthening of small farms. Direct selling is often portrayed as a marketing strategy for small farms. Direct marketing includes farmers' markets; pick-your-own fruit, flowers, and berry operations; cut-your-own Christmas trees; and roadside stands. Some farmers add recreational experiences in a rural setting to draw consumers to their farms. According to the 1992 Census of Agriculture, small farms are more likely to use direct selling—direct sales amounted to 2.1 percent of total sales for farms with under $10,000 in sales, compared with less than 1 percent for larger farms. Just under 6 percent of the operators of these smallest farms reported receipts from direct sales, totaling $65 million, an average of $1,300 per reporting farm.

Direct sales, however, mostly benefit farms in or near urban areas, where the bulk of direct sales occur. Farms in more remote locations need to take advantage of the growing interest in travel, tourism, and ecological/environmental issues to benefit from direct sales. Mail-order sales may also overcome the distance problem for some farmers.

Large supermarkets are trying to take advantage of consumers' growing interest in purchasing local produce and organically grown products. Independent supermarkets as well as large chains, such as Kroger and Giant Foods, are greatly expanding their programs to source and display "locally grown" produce. Small farmers may be able to improve their access to processors, retail stores, and other markets by joining or forming cooperatives that serve as the initial collection, sorting, grading, packing, shipping, and even processing points.

Contracting has become a common marketing option on farms of all sizes (*AO* May 1997). Farms with gross sales of less than $250,000 made up 80 percent of the farms producing under marketing contracts in 1993, although they accounted for only 33 percent of the total value of production.

Almost half of the 225,000 farms with marketing or production contracts in 1993 were small farms with sales between $50,000 and $249,999. This group of small farms produced about 24 percent of the total contract value of farm products. Crop commodities comprising most of the value of marketing contracts for farms with smaller contracts (less than $100,000 marketed) included field corn, soybeans, peanuts, almonds, and wheat. Milk, cattle, and turkeys were the most often-reported livestock commodities for a similar marketing contract size.

Contracting is but one part of the movement to larger scale in agricultural production and marketing. The trend also includes mergers and vertical coordination, which, along with contracting, may have a greater impact on small farmers in some sectors than in others. Mergers in the cereal industry, or even in the flour milling industry, for example, probably have little direct impact on small farmers, who typically sell their grain to the nearest elevator. Mergers and consolidation among elevators would have a much greater potential impact on small farmers than mergers in the processing sector. As elevators consolidate, small farmers may have to haul their grain greater distances, incurring higher costs.

Vertical coordination in the beef industry could make it more difficult for small farmers to find buyers. Small farmers tend to sell their cattle or calves to other farmers, to feedlot operators, or through auction markets. If slaughtering firms integrate backward by acquiring feedlots, these packer-owned feedlots may prefer to obtain large, uniform lots of cattle from larger farmers.

In the processed fruit and vegetable industry, however, processors have for years obtained the majority of their raw product from larger growers under contractual arrangements. Further consolidation in this industry would likely have little impact on small farmers. Small fruit and vegetable farmers instead tend to serve the fresh segment of the market or sell to small local processors serving niche markets.

Despite some of the obstacles, small farmers can benefit from a combination of effective marketing, better access to credit, and targeted programs, as well as the ability to take advantage of government programs, including those promoting sustainable use of farm resources.

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