Getting Started in Farming Is Tough

By Michael Boehlje and Ron Durst

Many have expressed concern in recent years over how hard it is to get into farming. This issue not only affects those attempting to enter farming, it also has become a policy matter at both State and national levels with particular emphasis on its implications for the structure and control of the farming sector and the future of the family farm. There are no legal obstacles to becoming a farmer; no examinations, no minimum education requirement, no licenses. Anyone who wishes may try. Substantial barriers to an otherwise legally free entry into farming do exist however.

Historically, a substantial number of new entrants have moved into farming by the "agricultural ladder." Thus, a potential farmer began as a hired hand on the home farm or a neighbor’s farm, and through hard work and wise spending accumulated enough money to buy a set of machinery. Subsequently the new entrant became a renter, then a part owner of real estate, and finally the pinnacle of success was reached with full ownership of land as well as machinery. Although the process required family sacrifices, the resource requirements were sufficiently modest that this procedure could be used successfully by a hard worker.

The "agricultural ladder" as a source of new farmers is now in question. With the substitution of capital for labor, the rapid price increase in durable resources (particularly land), and the expanding capital requirements of the economically viable farm firm, it is virtually impossible to acquire sufficient capital resources through this historically successful procedure. Besides, the procedure may not provide the entrepreneurial training so important for a successful new entrant in today's agriculture.

Barriers to Entry
Farming in the United States has changed markedly in recent years and is still rapidly changing. As late as 1940, labor accounted for over half the resources used in farming. Today labor accounts for less than 20 percent of farm resources, being replaced by sharp increases in the use of capital. This adjustment has fostered much larger farms and capital investments. The average size of farm has increased from about 175 acres in 1940 to 429 acres today. Capital investment per farm has risen from about $7,000 in 1940 to about $380,000 today. In fact, farm records show investments per farm have more than doubled each decade in recent times.

Being short of capital, a prospective farmer faces an increasingly difficult task of gaining control of sufficient resources to make successful entry. This is particu-
Farm records show that investments per farm have more than doubled each decade in recent times. These include farm machinery and equipment like that shown here on a South Carolina farm.

Successful use of modern farming methods, and of equipment like this soybean harvester in southwest Iowa, requires a high degree of technical knowledge and skill.
larly true of persons who must start with little family assistance. Of necessity, they must look for an opportunity that will make the most use of their labor when combined with their limited capital. Furthermore, because incomes and wage rates in off-farm employment are not rising as rapidly as the cost of farm inputs (particularly machinery and land), the strategy of working off the farm to obtain the necessary funds for entry does not always succeed.

Economies of size which result in lower costs as size increases also are an important consideration for the beginning farmer. Most studies indicate the cost curve declines rapidly with increases from very small to modest size farming units; after that point the cost curve becomes relatively flat with only modest reductions in cost with increased size. In essence, a “critical mass” of resources must be controlled to obtain reasonable levels of efficiency to be competitive.

As farms became larger and more complex, managerial requirements rose sharply. Successful use of modern farming methods requires a high degree of technical knowledge and skill. Handling large investments and cash flows in the face of high and rising costs, uncertain product prices, coupled with weather and other production risks, requires expert business and financial skills. It should be noted that some of these skills, particularly in the area of marketing and finance, are not acquired through the historical “hired man-agricultural ladder” approach to entry. Acquiring such skills may involve significant commitments of time and funds in formal training as well as practical experience.

One of the dominant characteristics of beginning farmers is limited capability to withstand risk. The beginning farmer typically does not have the equity base nor the experience to cope financially and personally with wide fluctuations in income. Family demands require at least sufficient income to provide a reasonable standard of living from the farming operation. Yet the agricultural sector is characterized by increasing risk. Thus an individual who frequently does not have the mental and managerial capability to handle risk is attempting to enter a high risk industry, usually with a large amount of debt and high leverage which multiplies the risk even further. This conflict between the risk-bearing ability of the young farmer and the risk inherent in agriculture may be one of the key barriers to successful entry.

Another barrier for the beginning farmer is resource control, particularly control of the land. Since much of the land in the United States is either owned or rented by established farmers with relatively strong financial positions, it is increasingly difficult for a beginning farmer to bid competitively in the purchase or rental market to acquire control of the land base. Furthermore, the high risk associated with cash rental arrangements for land multiplies the beginning farmer’s problems. Besides the risk associated with cash rental payments, many rental arrangements are short-term (one year) in nature, and thus the beginning farmer runs a risk of losing control of the land base after one or two years. With this tenure uncertainty, expansion in livestock which will typically generate the highest return to the beginning farmer’s limited capital and relatively large labor supply is difficult, if not impossible.
Maybe most important in the decision of whether or not to begin farming are lifestyle considerations. The living style in rural communities may require significant family adjustments. Schools, health services, shopping facilities, and cultural opportunities are often less adequate than those available in cities. In many small towns, everybody knows everybody and their business and personal affairs. The work hours are frequently long and there often is little flexibility for family vacations or just having a relaxing weekend. And although farmers' incomes have improved considerably over the years, uncertainty and possible financial setbacks are always part of farming. An important decision for those considering a farming career is whether they want the lifestyle.

Alternatives — Numerous entry alternatives are possible; the choice among them depends to a large degree on the experience and know-how of the new entrant and the availability of capital. We
will discuss alternatives that do not involve family assistance first; then entering with family assistance will be reviewed.

The Resident Manager — One key strategy for entry that may be particularly appealing for those who have little farming experience or capital is to become a resident manager of a large established farm operation. As farm businesses grow bigger, additional managerial talent is frequently required. This may be in the form of a herdsman for a particular phase of the business such as the dairy enterprise, or overall manager of the entire farm business under the owner’s supervision.

An advantage of the resident manager approach is that it can provide experience based on the latest technology in agriculture. It is important to choose an up-to-date operation that uses new technology if an entrant seeks experience by this route. Another major purpose of using this route for entry is to obtain knowledge of marketing and financial decisions. So the opportunity to exercise management authority and responsibility is important; avoid an operation that is simply looking for a “hired hand” to carry out the day-to-day farming activities.

In some cases, the resident manager’s role will be so challenging and the rewards so high that some may decide to remain in this role throughout their farming career. But for others, the question will eventually arise as to when to resign from the manager position and establish their own operation. One approach is to accumulate sufficient funds to acquire a smaller established farming operation when the opportunity arises and sufficient experience has been obtained to operate independently. An alternative is to use a phase-in approach. Accumulated savings can be used to purchase a piece of land which is then rented out. The advantage of this approach is that if the value of assets continues to rise, it may be possible to acquire control of some of these resources earlier at a lower price than if purchases are delayed.

Chance to Step In — On occasion, a prospective farmer has an opportunity to step in as a manager and part owner of a farming unit that is fully equipped and ready to go. The business is available because of illness, disability or death of the original farm operator, the lack of a farming heir, or for other reasons. Such a situation should prove particularly attractive to the experienced manager who has some capital. The basic resources needed are in place, and over time the manager can build equity to the point where eventual control is obtained over the operation.

In summary, a key advantage of the resident manager approach is the opportunity to obtain experience and knowledge without having to commit large amounts of one’s own capital. Such an approach may be particularly appealing to an individual who has strong formal training and motivation but limited capital and practical experience. Resident managership may offer the satisfaction of working with a larger unit. However, spinning off from such an operation to your own smaller unit may be difficult since it may require a change in lifestyle as well as farming technique, scale of operation, and risk.

Putting It Together Yourself

“Starting from scratch” involves putting all (or much) of the resources together yourself, with assistance only from a cre-
editor or supportive landowner. Under today's conditions, this option is generally feasible only for the exceptional manager with considerable equity of his own. Occasionally the exceptional manager (and family) can do it with limited equity following a period of part-time farming. Part-time farming may also serve as a hedge or a bridge — the nonfarm job can be used to augment income and reduce the risk of not having a reasonable standard of living from farming alone. Often, however, part-time farmers remain part-time rather than becoming full-time farmers; they get accustomed to a good family living and hesitate to give up the security they have acquired in their nonfarm job.

**Piggy-Back** — For many, the most realistic way to start farming is to piggy-back on someone else's operation (joint venture approach). This may be an outgrowth of earlier employment where the employer is willing to help you get started. The joint venture might involve leasing of land and the exchange of labor for machinery. In some cases certain major machinery items such as a tractor or combine might be leased or the machine services obtained through custom hire. Alternatively, the beginning farmer might purchase some equipment and then do custom work for others to offset part of the costs and generate income to service debt that may have been used to finance the purchase.

In most cases land rental is preferred to purchase for the beginning farmer with limited financial resources. Land typically generates a low cash flow per dollar invested and also requires a large capital outlay to obtain a “critical mass.” Cash rent or crop-share rental arrangements may be used. With crop-share rentals the landlord and the tenant share both production and price risk. Cash rentals require the tenant to bear most of the risks. Consequently, share rentals are preferred for most beginning farmers unless the cash rent terms are very favorable.

Finally, as noted earlier, capital is an important resource for the beginning farmer. The capital the owner can contribute includes savings and inheritances, and any family or other support or assistance. The latter may include a family member guaranteeing a loan, or directly lending funds to the beginning farmer. The assistance may also take the form of property sharing, such as exchanging labor for the use of machinery.

Most beginning farmers starting on their own must borrow a large proportion of the capital used in their farming operations. Numerous sources of credit are available including commercial banks, Production Credit Associations, Federal Land Banks, insurance companies, merchants and dealers, individuals, and government agencies such as the Farmers Home Administration. Most commercial lenders have only limited resources they can allocate to beginning farmers; the Farmers Home Administration has explicit farm ownership and operating loan programs that are tailored to the credit and financial needs of beginning farmers.

A farmer's credit worthiness depends on personal character as well as equity position and ability to service debt. Since most beginning farmers have limited equity, they must rely heavily on character and ability to repay debt from income when justifying a credit request. Consequently, a history of meeting financial obligations on time and an ability to de-
velop realistic projections of income and expenses (cash flows) are key attributes for the beginning farmer. Ability to use scarce resources effectively in generating needed cash flows, and evidence of success in keeping family living demands in check, also affect the amount a lender is willing to loan and the debt that can be serviced. Income from off-farm employment may also be an important source of cash for debt servicing for the beginning farmer.

Starting on the Home Farm
The home farm typically provides favorable opportunities for getting started in farming. The first and possibly most important opportunity is access to land and other types of farm capital. In addition, a farming venture on the home farm offers a valuable opportunity for gaining managerial experience under guidance and encouragement of the more experienced parents. Note, however, that establishing a successful parent-child farming arrangement requires careful evaluation of the current farm and family situation as well as a clarification of personal, business, and family goals. Some of the more important questions that need to be answered include:

Most beginning farmers starting on their own must borrow a large proportion of the capital used in their farming operation. The farmer pictured here has a 340-acre grain farm in Howard County, Md., and works closely with his banker.
What is the current farm business situation? What are current income needs of the parents? What are their expectations with regard to future income needs and financial goals? Is the farm business large enough to produce income sufficient to satisfy the current needs and future expectations of both parties involved? If not, can the farm business be expanded to a size sufficient to meet these needs? If expansion of the farm business is necessary or desirable, are the parents willing to incur more debt, and is the beginning farmer willing to reinvest a portion of farm earnings into the farm business? If expansion is necessary, how do both parties feel such expansion should be accomplished?

What are anticipated levels of involvement in the farm business at initiation of the arrangement? In 5 years? In 10 years? Is the ultimate goal of both parties to transfer the home farm to the beginning farmer (on-farm heir)? Are there brothers or sisters who want to enter farming in the future? If so, how will their interests affect the on-farm heir's eventual inheritance?

Answers to these questions will assist the parties in determining the type of arrangement under which the on-farm heir may enter the home farm business. Since family and farm circumstances differ, no one type of arrangement is suitable for every situation. In many cases, however, the on-farm heir will initially participate in the farm business under a wage agreement. As the heir assumes additional responsibilities, the agreement may be expanded into a wage-incentive or wage- and income-share plan. Such arrangements are particularly useful since they allow the on-farm heir to test his or her decision to enter farming with little or no capital investment. These arrangements also provide the parties an opportunity to determine if they can work together in a joint farming arrangement. However, the testing period should not be prolonged.

Spin-Off — Once these issues have been resolved, the parties should move on to arrangements which afford the on-farm heir greater financial and management responsibilities. If a more formal joint farming arrangement does not suit the family circumstances, then a spin-off operation might be desirable. Although this type of arrangement can take on many different forms, a typical situation might involve sharing labor and machinery while the parents and heir own or rent separate tracts of land. A situation may also exist in which the parents may be ready to reduce involvement in the operation. Under these circumstances, the heir may prefer to rent or buy part of the home farm.

Finally, if both parties want to farm together in a formal multiperson operation, they should determine whether a partnership or a corporate type of business arrangement would best suit the situation. Both the partnership and the corporation have their advantages and disadvantages. Generally the partnership can provide many of the advantages associated with incorporating, yet partnerships may be far less complex. However, the corporation usually provides greater opportunities for income tax management.

The ultimate goal of the business arrangement should be the transfer of the home farm to the heir. If this goal is to be met without seriously disrupting the farm business, several objectives must be considered in the early stages of
the arrangement. These include security for parents, equitable treatment of all heirs, and transfer of the farm with minimal estate tax liabilities and/or liquidity problems.

After operating the home farm for many years, some parents are reluctant to give up ownership and control of the farm business. This is especially true if farming is their primary means of financial support. However, tax and other farm business considerations may make it desirable to transfer at least part of the farm property to the heir who will be the future owner and operator of the farm business. Thus, the goal of providing income security for parents may conflict with farm management and tax planning goals. Retirement income security can be enhanced by income from business or nonfarm investments. Income may also be obtained through social security benefits or participation in self-employed or individual retirement plans. Regardless of the source, income security cannot be achieved overnight; rather, it must be established over a period of many years.

**Off-Farm Heirs** — Farm families with more than one child frequently face complications in transferring farm ownership to the on-farm heir. Most parents want to treat all children equitably. This goal can possibly be achieved by providing cash or other property not associated with the farm business to the off-farm heirs. In some cases it may be necessary to have the absentee heirs participate in the farm business either as landlords, debtors, or security holders. In such cases, the on-farm heir should be given the opportunity to purchase these interests at a fair price. Even with this option, however, without prior planning and continued communication among all interested parties, the farming heir could eventually face severe financial problems associated with buying out these interests.

The trend toward larger farms combined with the increase in the value of farm property, particularly land, have resulted in greater concern regarding impact of the estate tax on transfer of the farm operation to the next generation. While the amount of estate tax varies with size of the estate, type of assets contained in the estate, how these assets are owned, and how the transfer is to be done, virtually every farm estate can benefit from estate planning. The increase in the unified credit and enactment of the unlimited marital deduction in the Economic Recovery Tax Act of 1981 should ensure that, with proper planning, there should be little or no tax on the death of the first parent. However, death of the second parent could create serious tax problems unless there is careful tax planning.

Although circumstances vary greatly, certain techniques are especially valuable in reducing the estate tax burden. These include maximizing the unified credit upon the death of the first parent, making lifetime gifts, developing balanced estates between husband and wife, using testamentary trusts or life estates, qualifying for “special use” valuation and the installment payment of tax, and selling farm property to on-farm heirs on an installment basis or in return for an annuity.

Two tax provisions of particular importance to the agricultural sector in reducing tax and liquidity problems are special use valuation and installment payment of tax. Qualifying family farm and ranch
estates can value land at its “special use” (agricultural) value rather than fair market value. This can significantly reduce the value of the taxable estate and therefore estate taxes due. Since special use valuation is only intended for family farms which are to continue as family farms, numerous technical requirements must be satisfied to qualify for the provision. Qualifying could mean the difference between continued operation and forced liquidation of the farm business.

Even with proper tax management and estate planning, some farms will incur significant estate settlement costs and face the prospect of having to liquidate property to pay these costs. To reduce pressure to sell property to pay taxes, the Tax Reform Act of 1976 provided for paying estate taxes in installments. Under this provision, the Federal estate tax liability can be deferred for five years following death of the owner, and then paid in up to 10 equal annual installments thereafter. Interest is paid annually at a 4 percent rate (on the first $1 million of taxable estate) on the unpaid balance. This installment provision is generally available to estates in which the farm business comprises at least 35 percent of the adjusted gross estate.

**Fundamentals** — Following are some fundamentals the beginning farmer starting mostly on his or her own should be aware of:

1) Most successful businesspeople did not start at the top. So, therefore, don’t try to be too big too soon. Develop your unit over time, keeping its size consistent with your management skills and financial position. Establish a good track record as to your ability to generate and manage income. Have longer term goals that you are shooting for with plans for attaining them.

2) Most beginning farmers in this country are long on labor and short on capital. Consequently, allocate scarce capital to items that bring high return to capital invested (for example, fertilizer rather than land). Piggy-back when possible to reduce pressure for capital, plus provide management help. Substitute labor for capital when possible. Use smaller equipment and existing buildings where feasible. When possible, select labor intensive enterprises to make fuller, year-round use of the labor supply (as examples, dairy, hogs). Gain control of resources in ways that will give good returns and make effective use of leverage, yet protect liquidity position of the business (for example, crop-share rental). Cash flow demands as well as risk of large losses should be minimized. Manage risks carefully; employ insurance, marketing strategies, and possibly diversify operations.

3) Over time, capital availability will depend upon management capability. Therefore, establish a good production and financial record. Spend time becoming a better manager; develop your production, marketing, and financial skills. Secure management help when possible from the adult vo-ag instructor, creditor, professional manager, or another good farmer.

4) Keep fully employed and keep family living costs in bounds. While the unit is being developed, full employment may require off-farm work. Usually the starting family must sacrifice their standard of living to a substantial degree or no financial progress will be made.