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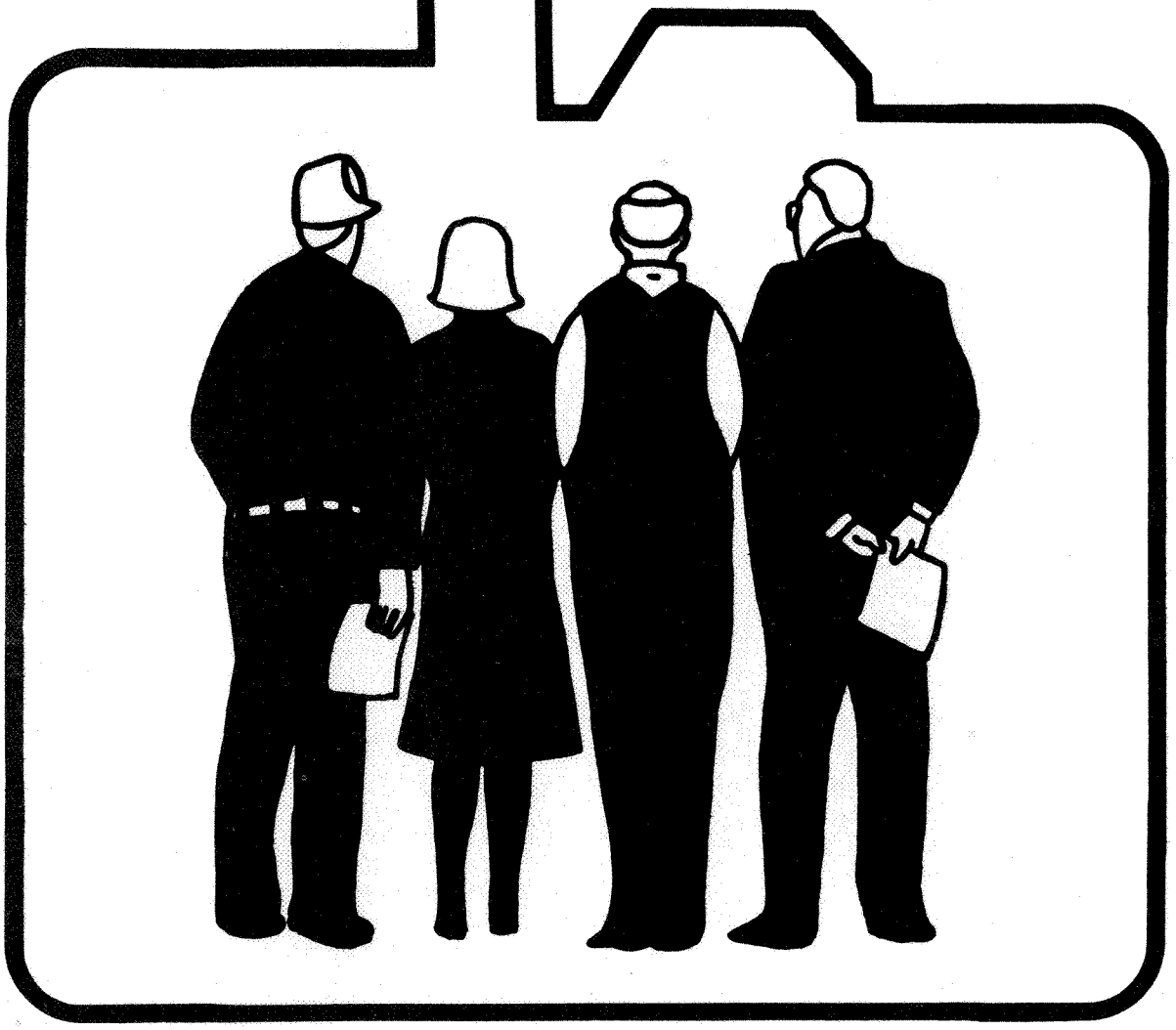
The Family Farm and Other Choices.....

ISSUES CONCERNING THE STRUCTURE OF AGRICULTURE



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The Family Farm and Other Choices....
ISSUES CONCERNING THE STRUCTURE OF AGRICULTURE

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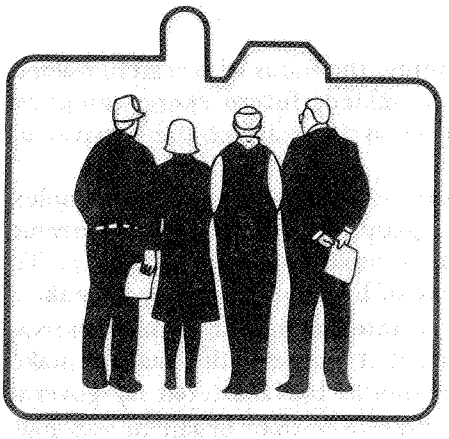

WHY ALL THIS TALK ABOUT THE STRUCTURE OF AGRICULTURE?

Harold D. Guither
University of Illinois

In the simplest terms, the structure of agriculture is the organization and control of the resources needed for farm production. Structure refers to the number and size of farms, the ownership and control of the land, labor and capital needed to carry on farming operations, and the control of production and marketing decisions.

Structure is influenced by the changing roles of the farm operator as laborer, manager, and decision maker. The supplying of production goods and services from off-farm sources and the changing nature of markets for farm commodities also bring about changes in farm structure.

Concern about structure among farmers and others involves both economic and social questions. Opinions may vary on the importance of changes in the structure of agriculture but issues such as efficiency, control, and social values appear to be major concerns.

...Concern about structure involves both social and economic questions...

Efficiency, expressed in such terms as yields per acre, pounds of gain per pound of feed fed, or similar measures, varies widely from commodity to commodity by region and by size of farm. There is no absolute standard.

Although gains in efficiency are often associated with large scale farming, there is often a concern about increased size of farms, concentration of land ownership and who controls production and marketing decisions. There may be a trade-off between the desire for efficiency and concerns about control.

Social values revolve around the merits of the family farm, the importance of land ownership as part of the family farm system, and the effects of reduced farm numbers and increased size on rural communities. At one time the farm operator and his family owned the land he farmed, supplied most of the labor and made all of the production and marketing decisions. His income was made up of returns for his labor and management, and rent from his land. Today, the farm operator may rent part or most of his land, hire more labor, and accept management decisions from off the farm. Consequently the returns may be divided among the farm operator as a laborer, the absentee landowner, and firms or individuals who make management decisions.

What's Happening to Farm Structure?

The traditional moderate sized family farm seems to be disappearing. Between 1950 and 1978, the number of farms declined from 5.4 million to 2.7 million. The largest farms, those with annual gross sales of $200,000 or more, comprised 2.4 percent of all farms but produced 39 percent of total cash receipts in 1978. About 7 percent of the farms, with sales over $100,000 produced 56 percent of all cash receipts. Farms with less than $5,000 in sales comprised 45 percent of all farms but produced only about 2 percent of total cash receipts.

Defining the Family Farm

Modern day farms are classified or described in several ways. Although there is not complete agreement, the types frequently mentioned are family farms, larger-than-family farms, small farms or smaller-than-family farms, absentee-owned farms, and industrialized farms.

Family farms are those in which the farmer and his family provide most of the labor and most of the management decisions. Generally, they will use less than 1½ man years of hired labor and are not operated by a hired manager. Family farm operators will own at least part of the land they farm and they must earn an acceptable living. Markets must be open for the products they produce.

Smaller-than-family farms will usually not provide satisfactory living for the operator who must depend upon outside employment for part of his income. Small farms usually refer to farms with less than $20,000 gross sales and the operators may earn more income from off-farm jobs than from farming. Absentee owned farms may be very similar to family farm operations but the operator rents all land from absentee landlords. Larger-than-family farms use more than 1.5 man years of hired labor but are not industrialized.

Industrialized farms use assembly line production techniques and their capital ownership, management, and labor are separated. The farm may be integrated into an industrial system of food and fiber production and distribution.

Part-time farms are those in which the operator is employed 200 or more days off the farm regardless of the value of farm sales. Commercial family farms are sometimes regarded as those with annual gross sales of $20,000 or more and which are not operated by part-time farmers.

Most farm businesses are sole proprietorships with the farmer owning the assets directly. Multi-ownership farms, such as partnerships and corporations, accounted for only about 10 percent of the farms in 1974, but being larger, sold nearly one-third of the farm products and farmed nearly one-fourth of the land.

...many people hold values about farming different from other occupations...

Corporations, as defined by the census, operate only a small number of farms but they accounted for 18 percent of all farm production sold in 1974. Some have very large acreage, others do not. They averaged 3,750 acres and accounted for more than 8 percent of all U.S. farmland. Most farm corporations are closely held by a few family stockholders. Sixty-nine percent of the privately held farming corporations were family owned with family members directly involved in daily production operations. Thus a corporate farm does not necessarily mean a large business corporation is in control.

The Cost of Entering Farming Is High

High land prices, lack of credit and the cost of farm equipment have all restricted access to farming.

The average farm in 1978 had total assets that exceeded one-quarter of a million dollars. The net worth of the average farmer was well over $200,000. However, there is a wide range in farm sizes, and many families own only part of the land they farm.

People's Concerns About Farm Structure

The declines in farm prices, the demands for emergency credit and the activities of the American Agriculture Movement signaled unrest and distress among farm families in 1978 and 1979.

In November and December 1979, the Secretary of Agriculture conducted a series of 10 meetings on the structure of American agriculture in which farmers, farm wives, farm organization leaders, and businessmen expressed their concerns. The most frequently mentioned issues and concerns included: barriers to entry into farming, inflation, the cost and availability of credit, estate and inheritance taxes, lack of open markets, preservation of agricultural land, adequate prices and incomes from farming, the focus of research, ownership and control of farmland, future energy supplies, and government policies as they affect the survival of the family farm.

Consideration of the policy issues is made complex by the fact that many people hold values about farming different from other occupations and businesses. To many, farming is a way of life, not just a way to make a living. For some, entry into farming and the preservation of a farm structure that enables individuals to make a living from farming should be facilitated by government as part of the tradition that began in colonial times.

Evaluating Agricultural and Food Policies

Many criteria could be used for evaluation of agricultural and food policies from an economic perspective and the welfare of farmers and consumers. The following will be given consideration in discussions of the major structure issues: adequacy and cost of the food supply, the welfare of producers, and the productivity of agriculture.

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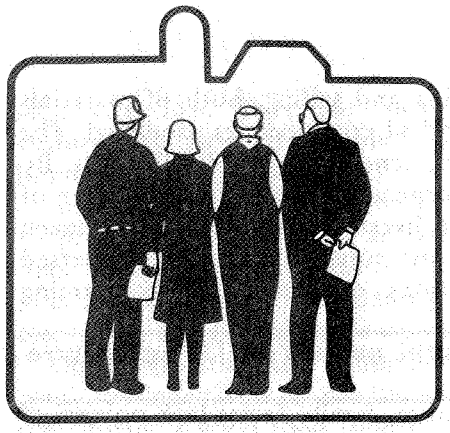

DOES THE FAMILY FARM REALLY MATTER?

Harold Breimyer
University of Missouri

A. L. (Roy) Frederick
Kansas State University

Family farms have been revered in America since the days of Thomas Jefferson. More than anyone else, he is given credit for identifying farms as places of individual opportunity. There, said Jefferson, various democratic values such as integrity, pride of achievement, and the work ethic could best be cultivated.

But as more complex technology and commercial management enter much of farming, and as the national economy becomes more urban-industrial, the question arises whether old values in agriculture can – and should – survive. To put it squarely: DOES THE FAMILY FARM REALLY MATTER?

Does it matter whether the agriculture of the future is composed of family farms – or of big-corporation farms, franchised or contract farming, tenant farming for absentee owners, or even new arrangements such as cooperative farms?

Does it matter to farmers, to consumers, to rural communities, to the nation?

Does it matter with regard to productivity, food supplies, conservation of natural resources, and protection of environment?

...survival or demise will be an outcome of policy actions...

These questions do not have definitive answers, but rather are posed to stimulate discussion and because public choice is involved. Present trends away from family farming result from national policy. Survival or demise will depend on policy actions taken in the future.

What is Meant by "Family Farming"

The farming that our founding fathers had in mind was seen as a welcome – indeed, sought after – change from the feudal system that had prevailed in medieval Europe. That system was class stratified. The landowner was lord and workers were serfs. Plowing fields and tending herds was the lowest form of employment.

By pleasant contrast, in the big and fertile new continent the farmer could hope to enjoy the exalted status of freeholder. He could both own and manage the land of his labors and receive its product.

That dream has never been expressed better than by the late John Brewster:

> In permitting the hitherto separate roles of lords and serfs to be recombined within the same skin, the . . . virgin continent gave working people the chance to . . . [become] free-holders . . . The emerging agriculture of family farms . . . generated within everyday people an envisioned realm of equal dignity and worth, which all America soon enshrined within her national self-image. . . .

The family farmer still plays a multiple role. He is owner, worker, and manager. Moreover, he is a marketer – and markets are open to him.

Family farms are implicitly of modest size, but size is defined in terms of what family labor can care for. Acreage, investment, or volume of sales figures are less applicable. The majority of all labor on a family farm is provided by the family. Thus, the amount of labor hired cannot exceed that provided by the farmer and his family. The maximum amount of hired labor is often put at either one and one-half or two man years. The key feature is that family labor dominates.

It is not necessary that all land be owned by the farm operator, but most family farmers will own at least part of the land they farm. A few may temporarily be full tenants, but neither widespread nor life-long tenancy is considered to be family farming.

Management may be vested in individual proprietors or family partnerships, but the right to make independent production and marketing decisions is crucial. Family farmers can freely buy supplies and sell the commodities they produce. If they must have production contracts or operate within the confines of marketing quotas, they are not truly family farmers. *Open markets are essential.*

Finally, even though family farms are not defined here by volume of sales or assets, a *system* dominated by a relative handful of very large farms would not be considered a family farming system, regardless of who owns, works on, or manages individual farms.

On the other hand, a family farm is not an uneconomic small farm. It is one where efficient production methods enable acceptable incomes to be earned in line with individual abilities.

Because family farming, like any human institution, stands in more danger of disregard than of denial, these definitional concepts must be adhered to fairly strictly.

Family Farming Not a Closed Shop

One of the most important intangible qualities of family farming is that such a system offers opportunity.

Young people have been welcomed into family farming. In recent years, sharp increases in the cost of entry have worked against preserving this characteristic of family farming. Entry barriers now accentuate the question of whether a system of family farms can survive.

The Trend Away from Family Farms

Present trends indicate that the family farm as the nucleus of U.S. agriculture is slipping away. These trends are not rapid. Nor are their dimensions easily measured, but the direction is clear.

There is evidence that we are moving toward a dual agriculture. At one extreme are many small farms, most of them part-time in nature. The smallest half of all farms, as defined by the Census, market only about three percent of all farm products. Most of these farmers depend on non-farm income for their living. They are not easily dislodged from farming although rising costs of fuel for transportation may work against them.

At the other extreme are very large farms. In 1978, 2½ percent of the very largest farms accounted for 40 percent of all marketings. Among the largest farms are some big landholdings, but commercial cattle feedlots, egg cities, and large hog operations are also prominent.

About one-sixth of all farm marketings come from contractually integrated production. Poultry and fruits and vegetables for processing are well known examples, but contracting extends across much of agriculture.

Family farms, intermediate in size and distinguished by their market connection, now contribute no more than one-half of all farm marketings.

Why the Trends Take Place

Ever since the 1930s federal legislation has endorsed the principle of family farming. Laws for farm price and income supports have almost always declared the intent to protect family farming. The 1977 Food and Agriculture Act goes one step further with its requirement that the Secretary of Agriculture provide an annual report to the Congress on the status of family farms.

Beginning in the 1940s some persons would argue that new technology, particularly larger field equipment, was almost totally responsible for the trend toward bigness in agriculture. Larger machines not only allow a farmer to cover more acres, but require larger acreages in order to spread fixed costs.

But many explanations now center more on financial incentives that favor larger farms. Farm program benefits, applied on a bushel or acre basis, favor larger farms. Tax rules favor high-bracket investors in agriculture, including high-income non-farmers. Larger farmers can often enjoy better access to credit.

Lack of access to markets may be the most subtle threat to family farms. By definition, a family farmer engages in open buying and selling, both of materials used in production and of commodities produced. The largest farms, however, tend to buy and sell direct. By bypassing local and central market firms, whether of machinery dealers or livestock auctions or a dozen others, they threaten the survivability of the dispersed local market institutions on which family farming depends.

...the farm family as the nucleus of U.S. agriculture is slipping away...

Almost by their nature, family farms lack powers of survival. The reason lies in the psychology of the family farmer, whose concentration on his own operation tends to distract him from concern for forces that affect family farming as a whole. This has been referred to as family farming's "non-instinct for self-preservation." Although many illustrations could be named, a prominent one is family farmers' support for income tax concessions. Each concession – a deduction from income subject to tax, or to the tax itself – looks attractive to the individual family farmer. But because of our tax structure, most concessions are relatively more advantageous to the high tax-bracket investor, whether farmer or non-farmer. Their net effect is injurious to ordinary family farmers.

High Productivity and a Good Food Supply

Among the questions associated with family farming, the productivity record of family farm agriculture has been perhaps most widely acclaimed.

American consumers have an abundance of nutritious food available to them. In addition, sizable quantities of farm products, most notably the grains, are exported to foreign markets each year.

But the record does not *prove* family farming to be more productive than, say, a system organized along the lines of industrial corporations or even a tenant-dominated agriculture. Big, well managed corporations, for example, are especially adept at using the latest technology. And non-farm landlords relieve operating farmers of the burden of raising capital for purchase of land. Certain operations such as commercial feeding of cattle can show some economies of large size. The big new hog facilities may also have a genuine advantage. But these hog facilities are often subsidized by income tax deductions. It remains to be seen whether they can weather the low price period of the hog cycle better than family hog farmers can.

There are some production economies in farming up to about two man years of labor. Beyond that size the output per unit of input changes little. Hence, productivity differences between the well managed family farm and most other kinds of farming are not wide enough to be the sole basis for a policy choice.

It is sometimes argued that during bad times family farms assure a good food supply better than other kinds of farming. Family farmers continue to work even when

income is low. They use their living standards as a cushion in a way not possible in a system dominated by hired workers and managers.

Socialist countries offer evidence that workers tend to produce more on plots set aside for their own use than on land under control of the "farm." By analogy, it is argued that poor husbandry could be expected of employees of a big, distant corporation.

On this question too a judgment must be guarded. It would be inaccurate to conclude that only family farms can provide a good food supply. Large-scale production of certain fruits and vegetables has proved feasible.

...lack of access to markets may be the most subtle threat to family farms...

Going beyond production efficiencies, could farming operations get so large as to exert damaging market power? Particularly if the big firms can join together, directly or tacitly, they may be able to lift the price of farm products exorbitantly and resist price declines when supplies are large. This is the threat posed by large-unit agriculture to which consumers are most sensitive. Nor is there clear evidence that higher prices imposed by huge firms would help workers on the land.

Conservation of Soil & Protection of the Environment

Farm leaders often declare that family farmers accept a stewardship relationship to soil and the environment. Family farmers want to preserve farm productivity for future generations, it is said. By implication, other farmers are thought less likely to be good stewards. This attitude prevails widely and is sincerely believed.

Unfortunately, not all family farmers have lived up to those noble ideals. Some family farmers have plowed erodable land without proper concern for the ravages of wind and water. More than a few have been careless in the use of chemicals. The problem is the conflict between the short term income needs of farmers and the long term needs of resource preservation.

Potentially, the family farm tradition is positive toward conservation and environmental protection. But measures to improve conservation and regulate use of chemicals will necessarily be initiated through government. Family farmers will cooperate as well as others, but family farming is not a guarantee by itself of adequate conservation and environmental protection.

Financial Welfare of Persons Engaged in Farming

Family farmers have frequently not fared well financially, especially over short periods of time. The succession of "farm programs" enacted since 1933 is evidence of the public's concern about the financial well-being of farmers, especially family farmers.

But how would those engaged in farming fare in other structures?

Some "farmers" could become employees of industrial-type corporations. They would qualify only for wages and salaries. Over time, their income would become quite similar to earnings in industry. But those individuals would get no returns from managing or landholding, as a family farmer does. Wage workers, and some salaried ones too, would eventually be unionized – perhaps to their gain. They would be protected by unemployment insurance and other fringe benefits that go with industrial employment. They would also be subject to seasonality in employment and lay-offs.

What about family farming versus full tenancy? The tenant farmer receives only that income generated by his labor and by the amount of capital he provides. He gets none of the return creditable to land. Moreover, the historical record is that when tenant farming becomes widespread, it is difficult for the tenant farmer to protect his income because of the intensified competition for land.

Hence the question of financial returns brings us back to the multiple role of the family farmer. The farmer who owns at least part of his land gets a combined income from land, labor, capital, and management. Over time, as land becomes relatively scarcer, more of the total return generated in farming (including capital gains) will go to the holder of land. Therefore the family farmer will enjoy a growing advantage over farm workers, tenants, or contractees. Incentives will also increase for individuals who are not operating farmers, or large corporations, to acquire land in order to receive the increasingly attractive returns to it.

Surviving family farmers may nevertheless need a certain amount of protection, as now, against unstable prices and incomes.

Opportunities and Other Values

The Jeffersonian advocacy of the family farm originated in a combination of economic, political, and social forces.

In the early 19th century, land settlement was critically important to the economic growth of the nation. Family farmers who cleared land and plowed the virgin soil provided the underpinnings for increased commercial activity.

There also was a belief that those who owned and lived on the land would want to protect it, their home, their community. Family farmers were seen as responsible citizens and the backbone of a democracy.

The idea that life on the land develops superior personal qualities is known as agricultural fundamentalism. The doctrine still has strong adherents even though farmers are less different from non-farmers than they used to be. Perhaps the most that can be said about the differential worth of the farming environment is that it is necessarily personal.

...it would be inaccurate to conclude that only family farms can provide a good supply...

However, Jefferson saw those good attributes as attaching to the proprietary or family farmer. They would be less visible in wage workers or lifelong tenants. The

man or woman in charge of his or her own land and livestock is, supposedly, the one most possessed of "fundamental" values.

It was easier to realize the Jeffersonian dream when the open frontier was an invitation to opportunity. It is not so today. If the qualities of family farming are deemed meritorious and are to be preserved, conscious effort must be made to keep the door of opportunity at least partway open.

Does the Family Farm Matter to the Rural Community?

Of all questions about the qualities of family farming that of its meaning to the rural community offers the most clear-cut answer.

Whether or not family farming is preserved *does* matter to the rural community.

The question cuts two ways. First, does family farming contribute to the financial strength of local businesses? Secondly, are proprietary farmers better community participants than farm wage hands, tenants, or contractees?

An especially strong case can be made for a yes answer to the first question. Family farmers buy most of their inputs from local suppliers (including their cooperatives). They sell the majority of their products into local or regional markets. Much of the business enterprise in rural towns and small cities is farm-connected.

By sharp contrast, large corporations engaged in farming are less likely to get their credit from local banks, their machinery from local dealers, or their fertilizer from the local farm supply firm. They are also more likely, as noted previously, to sell their products directly to a distant market or processor.

An absentee-landlord agriculture lies midway between family farming and big corporations in support of local businesses. Tenants do not bypass local suppliers and markets the way big corporations do. Even so, absentee-landlords, like industrial corporations, drain more of total farm income away from the local community. Less of it remains to be spent locally for farm inputs and especially for food, clothing, recreation, and other items for family living.

How well farmers of various categories enter into local community activity is more difficult to generalize. Family farmers clearly enter into community activities more actively than wage workers. Workers hired daily or weekly contribute little to the community.

Few data are available on how well tenant farmers participate in community affairs.

According to William Heffernan, the pattern for farmers producing under contract is mixed. Some contracting farmers have low incomes and may feel themselves to be of low standing in their communities. But contractual producers of vegetables for canning, even though they have transferred much risk bearing and management to the contractor, enjoy relatively high income and hold positions in their communities.

Owners or managers of large, industrial-type farms who live outside the local community would assume few civic responsibilities within the community.

Summary and Implications

This leaflet has presented the unchallengeable data on the gradual decline in family farming, the more judgmental notions as to why those trends are occurring, and the highly personal concern as to whether the trends matter.

Whether those trends matter depends on one's appraisal of the impact to be expected from a highly concentrated agriculture, as contrasted with dispersed family farming. In an industrial-type structure, the incomes of persons working in farming might be protected reasonably well, especially if all the trappings of unionization and fringe benefits were added. But those persons would still be wage workers. Hence the nagging question arises once more: How much importance is to be attached to the status of the family farmer who both labors on the land and owns and manages it?

Where does the public interest lie? When both economic and sociological values are taken into account, is it better to have a farming sector of proprietary farmers who provide most of their own labor as well as capital and management? Or is there nothing to fear from a class-stratified agriculture – either one of tenancy as farmers work the land held by absentee landlords, or one of industrial corporation control through contract in which "farmers" are essentially wage-hands?

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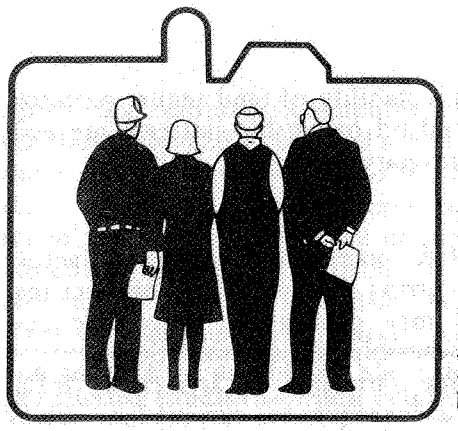

DO LANDLORDS MAKE A DIFFERENCE?

Duane A. Olsen
University of Nebraska

Bruce Johnson
University of Nebraska

Land ownership and control are closely linked to farm structure. Real estate accounts for more than 70 percent of farm production assets and has considerable influence upon the financial well-being of the farming sector. Moreover, the quality and the limited supply of farmland have an impact upon the organization of farming and the performance of the agricultural industry.

Land ownership, its patterns and trends, is an issue of primary importance. How prevalent is ownership by landlords? Who are these landlords? More importantly, does their ownership affect public concerns about: 1) the efficiency and dependability of food and fiber production; 2) the preservation of the resource base; and 3) economic and social well-being of the rural community? Our purpose here is to encourage thought and discussion about these questions.

Family Farm, Landlord and Absentee Land Ownership

Historically, family farmers have been identified as those who operate and own, or plan to buy, part if not a significant portion of their land. They combine land ownership with operatorship and expect to reap the returns earned by their labor, management and capital invested in land and other resources.

When landlords enter the picture, there is a transfer of operatorship from the owner to a tenant through a mutually agreeable and legally binding agreement. Quite simply, the role of ownership is separated from operatorship. Our data is based on this definition, and this allows us to look at the present situation and recent trends. However, it ignores wide variations that exist among landlords in the residence, occupation and many other characteristics important to the behavior of landlords and landlord-tenant relationships.

"Absentee" is a term commonly reserved for landlords thought to be far removed from their land with little participation in management. Distance, or physical separation is often a primary distinction which may limit the landlord's participation. Yet, the separation of ownership from operatorship may be influenced by several other factors. Table 1 presents some of the subjective factors that may contribute to the "degree" of absenteeism in landlord-tenant relations. Obviously, there is wide variation in the characteristics of absentee landlords. None-the-less, there is a general perception which associates absentee land ownership with potentially conflicting landlord-tenant relations.

Table I. Qualitative Characteristics and Potential Landlord-Tenant Interaction Patterns.

	Landlord-Tenant Relations	
Landlord Characteristics	**Potentially Cooperative**	**Potentially Conflicting**
Residence	Local	Out of state or region
Cultural Values and Norms	Agrarian & Rural	Non-farm, Urban
Communications Methods	Personal, Informal	Impersonal, Formal
Farmland Portion of Total Wealth	Major Importance	Minor Importance
Practical or Basic Farming Knowledge	Current & Substantial	Non-existent or out-of-date

The table identifies some of farm landlords widely varied characteristics. At one extreme is the recently retired farm operator or widow who remains a resident of the community. Their land is often rented to old friends or neighbors. These landlords have an economic livelihood and personal interests that usually parallel those of family farmers. Society commonly envisions a cooperative relationship between these landlords and their tenants. In contrast is the "absentee" landowner who resides in a distant community and is perhaps one or more generations removed from farming. A large separation between ownership and operatorship is implied. As the size of this gap increases, the difference in landlords and tenants goals, knowledge and management ability may become even greater. These differences hold potential for landlord-tenant conflict.

The wide separation of ownership and operatorship attributed to absentee landowners has produced both real and imagined concerns. These concerns grow from a perceived threat to conventional values long associated with traditional family farms. Therefore, the nature of the separation between ownership and operatorship is one important feature of an assessment of agriculture's structure and society's goals.

FARMLAND OWNERSHIP IN PERSPECTIVE

Despite its importance, we know surprisingly little about the nature of U.S. farmland ownership. However, recent research provides several indicators that help describe the situation, trends and pressures for change.

The Situation

- Private landowners hold most of the nation's farmland. A 1978 U.S.D.A. survey indicated nearly 940 million acres of farm and ranch land were held by 6.9 million private individuals, partnerships, and corporations.
- Farm owner-operators hold more than 6 out of every 10 acres of U.S. farmland. In 1974, farmers owned 63 percent of the land they operated.
- While landlords owned 37 percent of U.S. farmland, their land holdings differ substantially from state to state. In the North Central region, for example, their farmland ownership ranged from 20 percent in Wisconsin to 54 percent in Illinois for 1974.
- Landlords often have close ties to agriculture. Of the 383 million acres they held in 1974, 14 percent was owned by active farmers who rented out their land to other farmers. A more recent 1978 U.S.D.A. study indicated approximately one-third of such land was owned by retired individuals. It is likely that many of them are retired farmers or former farm family members.

Emerging Trends

The proportion of full tenant farmers (who rent all the land they operate), declined from 42 percent of U.S. farmers in 1930 to 11 percent in the mid-1970's. Meanwhile, the proportion of part-owners increased. These part-owners now operate more than one-half of U.S. farmland. Rising land values often prohibit full ownership of all the land required to fully employ a farmer's labor and equipment. Part ownership offers some farmers the opportunity for a larger land resource base while retaining some of the advantages of ownership.

For the past 30 years, the proportion of farmland held by landlords has remained at about 37 percent. While certain economic factors may have stimulated interest among non-farm investors, active farmers remain the dominant buyer group in local land markets.

While concern has resurfaced over foreign investment in U.S. farmland, recent U.S.D.A. studies estimate foreign investors hold an interest in no more than one-half of one percent of U.S. farmland. Furthermore, foreign purchases do not appear to be a major factor in the market for farmland, although they may be relatively important in some localities.

Despite "land boom" conditions over the past decade, roughly 2 percent of the farmland base is transferred in any given year. While the resulting land market appears thin and perhaps vulnerable, the low rate of transfer also implies a stability of land tenure patterns. Changes in U.S. farmland ownership patterns are evolutionary, not revolutionary, in nature.

Pressures for Change

Several subtle, but potentially profound factors underlie changes occurring in the market for farm real estate. Such forces may change the magnitude and nature of landlord ownership in the United States.

Inflation has made farmland an attractive "inflationary hedge." As a consequence, current land values reflect, to varying degrees, an anticipation of further appreciation. The result has been land prices which exceed levels justified by those current returns upon which many farm operators must depend for their livelihood. A logical outcome is a gradual change in the mix of land buyers. Higher-income investors (including some farmers) with ample debt-carrying capacity will become more prevalent while young farmers with modest cash flow potential will find land purchases difficult.

...when landlords enter the picture...ownership is separated from operatorship...

Certain federal tax provisions also provide further incentives for high income investors to buy farm real estate. Farm expenditures which effectively reduce annual taxable income and improve the opportunity to capture long term capital gains can be used to defer taxes and reduce tax obligations.

In essence, inflation and tax provisions foster a gradual shift of farmland ownership toward those with established wealth. They may point toward an increasing degree of absenteeism among farm landowners. The same forces also encourage established farm families to maintain and expand their land holdings. Presently, agriculture does not exhibit the concentration of ownership that exists in many other sectors of the U.S. economy. However, the forces described above may lead to the eventual development of a landed aristocracy.

CONSEQUENCES

The family farm system, closely linking ownership and operatorship, has dominated the structure of agriculture. Traditional expressions of concern for the family farm are based, in part, upon the expectation that this system will produce individual decisions closely compatible with the interests of society. In contrast, absentee ownership is often viewed with suspicion and skepticism. To some people, an increasing degree of absentee ownership suggests a further separation of public and private interests which could result in socially undesirable outcomes. Four public concerns have been selected in examining the question "Does landlord ownership make a difference?".

Production and Food Supplies

One of society's prime concerns is for an adequate, safe and affordable food supply. The efficient use of

agricultural resources contributes to that goal. By most standards, the U.S. food production system has satisfied these performance goals. Food and fiber surpluses occur more frequently than shortages, and U.S. consumers spend a relatively small share of their income for food. Moreover, agricultural exports are substantial. About one acre of farmland is used for export production for every two acres used for domestic requirements.

...a perception associates absentee ownership with conflicting landlord-tenant relations...

Have landlords contributed to the progress of U.S. agriculture? The adoption of certain technological advances and specialization has often been closely associated with increased farm size. However, the limited amount of farmland for sale and its high cost present a formidable barrier to land purchases. Full ownership has declined while part-ownership has increased dramatically. Rented land parcels are often included in larger operating units. This is most apparent in the cash grain producing regions. By making it possible to increase the acreage operated, rented land has improved the capacity of some farmers to adopt productivity-improving technology.

Advocates of the traditional family farm system may question whether tenants farm land as efficiently as owners. In part, they believe limited resources or economic incentives may result in lower land productivity. Local exceptions may exist, but there is little research which supports the view that tenants farm less efficiently than owner-operators. Quite the contrary, competition for rental parcels is usually keen, dictating top quality management simply to hold onto leased land. Landlord-tenant contracts have frequently evolved over time to form a kind of "partnership" with a mutual trust and common understanding that discourages second-rate management or depletion of the farm resource.

In summary, the rental market historically has functioned reasonably well, supporting improvements in farm efficiency and the productivity of the agricultural industry. In the future, the possibility of greater absentee ownership could change this situation. The current rather personal, often informal and responsive landlord-tenant management system could be replaced by a more formal, sophisticated system. The impact of such changes upon the efficiency of a land based agriculture is uncertain and an appropriate topic for further investigation and debate.

Flexibility and Adaptability

Farm rental arrangements tend to be traditional — closely following local customs. This is particularly true of crop share agreements, although cash leases also follow rather well-defined patterns. As a result, leasing agreements may tend to lag behind and temporarily fail to accommodate changing conditions. Dramatic increases in diesel fuel costs, for example, have created a condition of concern to crop share tenants, particularly for those in irrigated areas. Such changes can create an imbalance in the customary landlord-tenant share of costs and returns. Until the rental arrangements adjust in response to this new condition, farm resources may not be used with maximum efficiency.

In a broader sense, however, the opportunity to rent farmland has been important to the flexibility of the agricultural industry. Currently, many part-owners control a sizeable farmland acreage without the financial burden of complete land ownership. Simultaneously, these farm operators avoid the barrier imposed by limited capital while gaining the flexibility to adjust acreage from year to year. Additionally, crop share arrangements and flexible cash leases can effectively transfer some risk to the landowner. For those farmers with limited cash flow, this can contribute to "staying power."

The future seems to hold far greater risk and uncertainty for farm production. Future restrictions upon the supply of key inputs and the increasing importance of a volatile world market will produce added uncertainty. The agricultural industry will require greater flexibility to accommodate these external forces. The degree of landlord ownership and the nature of landlord-tenant interaction is apt to become increasingly important to the flexibility of the agricultural industry.

Agricultural Conservation & Environment

Absentee owners, far removed from their land, are sometimes accused of an indifferent attitude toward conservation. In contrast, family farmers are commonly characterized as "tillers of the soil," with both a stewardship concern and the working knowledge adequate for the job. As is often the case, neither of these extreme views is totally accurate.

Indeed, relatively short-term planning horizons may guide the land management decisions of landowners with a heavy debt load or speculative investment goals. Similarly, tenants who rely upon annual leases and an uncertain renewal, are apt to develop land management strategies from a year-to-year point of view. Under these conditions, conservation and environmental efforts which won't pay off for several years are not likely to be employed.

However, many other factors indicate that landowners and tenants are likely to have planning horizons much like family farm owner-operators. Numerous conservation and environmental practices are expected to improve farmland productivity and ultimately increase both annual earnings and the value of the land. Therefore, these practices do offer benefits for all landowners. Furthermore, landlords may be just as interested in transferring their property to a succeeding generation as family farmers. Therefore, landlords, as well as owner-operators, can be motivated by the desire to maintain the "store of value" present in their land. Furthermore, should land ownership move toward the more finan-

cially well-established owners, both added concern and financial capacity for such investments may result.

...for the past 30 years, farmland held by landlords has remained at about 37 percent...

Research results indicate tenants are also likely to base their decisions on a longer planning horizon than one year. While most leases are year-to-year agreements, renewal tends to be the rule rather than the exception. Even though competition for rental land is keen, leases are usually renewed – often for more than a decade. Improved conservation and environmental practices would be expected to have impact within that length of time. Therefore, most tenants as well as landlords, have reason to use planning horizons similar to family farm owner-operators in their land management decisions.

Publicly supported programs have been introduced when the performance of agriculture has fallen short of society's conservation and environmental policy goals. These programs have relied primarily upon financial and technical assistance, although regulatory measures are also now being imposed. Such expressions of public interest are basically indifferent to patterns of private ownership. For landlords and tenants they represent a third party to accommodate in the decision making.

Agriculture and Rural Well-Being

Public attention has often focused upon the economic well-being of farmers and rural residents who depend on agriculture for their livelihood. A reasonable level of living for those who provide labor and management is essential for the viability of this industry.

Absentee landowners are sometimes characterized as the villains who drive up farmland prices, thus raising entry barriers. However, as previously noted, most land parcels continue to be purchased by established farmers to expand their operations. Furthermore, the absentee investor's demand for land can also be beneficial. Tenants and a growing number of part-owners have acquired rental land to utilize larger, more efficient technology and raise their family income.

Changes in the structure of agriculture also have affected nearby communities which normally supply goods and services for both farm operations and family living. The increase in farm size and reduced farm numbers has been accompanied by similar changes among many businesses providing those goods and services.

...inflation and tax provisions foster a gradual shift of land ownership toward those with established wealth...

Ownership by landlords can have widely varying effects upon rural communities. A certain cash drain or leakage from the local economy occurs when cash or share rent is paid to absentee landowners living outside the community. However, many landlords reside within these communities and contribute to their economy.

In recent years, considerable wealth accumulation has been associated with rising land values. The local economy receives positive benefits if the increased wealth results in greater local purchases of goods and services. But, if these landowners reside elsewhere or choose to live frugally, the local economic impact is minimal.

Finally, with regard to the public sector, the property tax base provides an opportunity for the community to capture a portion of the benefits resulting from rising land values, irrespective of ownership. The absentee owner is a taxpayer perhaps with little opportunity to derive direct benefits from some of the local public services he helps finance.

A FINAL NOTE

Farmland ownership continues to be dominated by people with close ties to the traditional family farm and its associated values. Over time, however, significant changes may occur in the pattern of farmland ownership. Further increases in the concentration of farmland ownership among wealthy investors and established landowners are possible, perhaps with a greater separation of ownership from operatorship. Any increase in absenteeism has both positive and negative effects upon the performance of the agricultural industry. Consequently, a continuing assessment and evaluation of land ownership patterns will be necessary to balance these public concerns with the freedom and values traditionally attributed to the family farm system.

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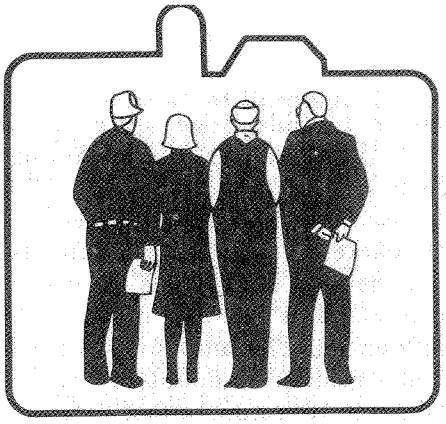


IS CORPORATE MANAGEMENT OF FARMING A THREAT?

Dennis R. Henderson
Ohio State University

James D. Shaffer
Michigan State University

Thomas Jefferson and many of our founding fathers had an image of the ideal society as one based upon an economy of independent family farms, small businesses and artisans. Jefferson actually opposed the chartering of national corporations because he was concerned with the potential concentration of power inherent in the corporation. Yet, the story of American economic development involves the shift from an economy managed by decisions of family farmers and other small businessmen to those of large corporations. The family farm remains but accounts for only 2 percent of total national net income. This report describes the extent to which management decisions by large corporations have replaced those of family farmers.

Corporate Management of the Food System

Corporate management dominates the total system by which we produce and distribute food and fiber. The farm is but one type of production unit in this integrated industrial system.

To understand the pervasive nature of corporate involvement in farming it is necessary to recognize the nature of the industrialized food system. New technology has replaced labor on farms and work roles in the system have become highly specialized. One-time farm jobs such as feed formulating, fuel and fertilizer production and product conditioning and marketing have been specialized and restructured into off-farm jobs. On-farm employment has been steadily declining, being replaced by off-farm employment in farm supply, product marketing and other agribusiness activities. The production and distribution of food and fiber involves the coordination of the activities of many specialists.

Large corporations control or influence decisions in farming through: (1) direct corporate ownership and management of farm enterprises, (2) corporate management through contractual arrangements, and (3) corporate influence of management decisions through control of farm input and product markets.

Ownership of Farms

The most obvious involvement of corporate management in farming is actual ownership of the farm enterprise. But it is not the most significant. The 1974 Census of Agriculture shows that only about two percent of all farms in the U.S. are owned by corporations. These are also among the largest farms, accounting for 18 percent of total farm production. These statistics tell a misleading story, however. Most corporate-owned farms are really incorporated operator-owned or farm family-owned farms. Only six one-hundredths (0.06) of one percent of all farms (about three percent of all corporate owned farms) are owned by publicly held corporations whose primary business is something other than farming.

Precise data on the nature of these farm-owning corporations are not available, but it is realistic to assume that some have little or no other agriculturally related activities, but are nonfood (or fiber) related firms that own farms for speculation, future land needs or other reasons. Thus, something less than four percent of U.S. on-farm production appears to be under corporate management through direct ownership. Higher estimates, up to ten percent, have been made. But our estimate is what is revealed by official data.

The single fact of incorporation does not significantly alter the management or control of the family farm. Neither do we address the issue of family farms which happen to be managed by an incorporated farm management service. We assume that such farm management firms work with a tenant who farms in much the same way as a family farmer who owns the farm. There is the issue of separation of management and ownership and the absentee owner, but that is a different issue than management or control by large corporate firms.

Contractual Agreements

Next to direct ownership the contractual agreement is the second most obvious involvement of corporate management in farming. To coordinate farm production with the needs of the large corporation a great variety of integrative agreements are made between the agribusiness corporations and operators of farm enterprises.

These agreements involve various degrees of corporate influence over farm management. Perhaps most familiar is the production contract, whereby farm operators enter into formal agreements with agribusiness corporations concerning such management decisions as what is produced, how it is produced, what mix of purchased

inputs is used, when and how farm products will be harvested and/or delivered to the next stage in the marketing channel, what price will be paid for inputs, and how much the farm operator will be paid. Under some such contracts, the farm operator supplies little more than land, buildings, and labor, with most other capital and management supplied by the corporate contractor.

Production contracts between farm operators and corporate agribusiness accounted for more than 17 percent of total farm production in 1970, the most recent year for which data are available, and the share appears to be trending upward. Probably the most frequent use of production contracts is in the broiler industry, where 90 percent or more of total production is contract integrated. In this industry, feed manufacturers have been the primary contractors. Farm operators have relinquished most managerial freedoms while the integrator corporations have established industry-wide product and production standards which have resulted in a supply of more uniform, consistently available, and less expensive broiler products to consumers. While broilers are the best known, production contracts are also dominant in other industries including sugar, citrus fruits, processing vegetables, seed crops and turkeys.

...most of the agriculture-food system appears to be dominated by a few large corporations...

A more subtle and perhaps less complete exercise of corporate management occurs through marketing contracts and agreements between farmers and agribusiness corporations. Such contracts and agreements range widely in scope and in the extent to which corporate management directs the farm enterprise. At one extreme is the market specification contract where, sometime before harvest and perhaps before initiating production, the farm operator and corporation establish a fixed basis for determining subsequent delivery and pricing. These contracts transfer much, if not all, marketing management from the farm operator, while only indirectly affecting other farm management decisions. Marketing contracts between milk producers and fluid milk distributors are typical examples.

At the other extreme is the informal private agreement which standardizes or routinizes trading arrangements between the farm operator and the agri-business firm. Such informal agreements usually provide for regular delivery of loosely specified quantities and types of product, along with a method for pricing that does not require bargaining over each transaction. Such agreements are usually open-ended and stand as long as both parties are reasonably well satisfied. Formula pricing arrangements between egg producer-packers and chain retailers and between operators of cattle feedlots and large meatpackers provide illustrative examples.

The extent to which corporate management of farming is carried out through marketing contracts and agreements is not definitely known. However, almost all table eggs are produced under formula price agreements. About 80 percent of all milk is subject to a marketing contract as is about 20 percent of all fed cattle. Over 60 percent of all slaughter cattle and swine are subject to some form of a private marketing agreement. Contracts and agreements are of increasing importance for grains and oilseeds. Overall, as much as one-half of all farm production may be influenced. The amount of actual influence over farm management undoubtedly varies from very little to significant. We estimate that between 5 and 20 percent of all farm management decisions are currently being transferred to agribusiness corporations.

Combining the possible impacts of marketing contracts and private agreements with production contracts and direct ownership, corporate management currently appears to directly influence at least 25 percent of all farm production and perhaps as much as 40 percent. The trend appears to be upward.

Control of Markets

Less obvious and direct is the influence on farming of agribusiness corporations through their influence on the supply of farm inputs and demand for farm products. The dominant food system corporations are large, diversified and have agriculturally-related activities that are primarily nonfarm – mainly food manufacturing, food distributing and farm supplies. While there are several thousands of such firms in the U.S., the number is declining rather steadily and the concentration of business in the hands of a relatively few large corporations is considerable.

The 50 largest corporations in food manufacturing, for example, account for about two-thirds of all food manufacturing and their share has been increasing by 1.5 percent annually since the early 1960s. These large corporations dominate in the marketplace, with the largest four firms in each farm supply industry, food manufacturing industry, and metropolitan retail food market accounting for an average of more than one-half of total sales. Most segments of the agriculture-food system, therefore, appear to be dominated by a relatively few large corporations.

Several examples illustrate the nature of this influence. Decisions by machinery manufacturers on size and types of harvesting equipment influence the relative cost of harvesting different crops and may determine the crops which can be economically produced. Size of equipment also influences the size of farms. Retail stores have limited shelf space and the decisions of managers of a few chains determine access to this space. Retail chains and buying groups buy many products according to their specifications which influence varieties, timing and location of plantings. A decision to include a cherry pie on the menu of a very large fast food restaurant greatly affects the demand for cherries.

Characteristics of Corporate Management

Each corporation, like each individual, has unique features. Yet, there are enough similarities among the major agribusiness corporations which influence farm management that a general description is possible. Large corporations have two distinguishing characteristics: (1) they are complex organizations with many similarities to other bureaucracies, and (2) they have some control over or discretion within their markets. There is a decision making hierarchy comprised of professional managers (the management class) who are distinct from both labor and stockholders. The major functions performed by the organization are more or less coordinated by a set of standard management or operating procedures.

These firms are large enough and have sophisticated managers who can exercise some degree of control over their markets. Corporate behavior is also influenced by the organizational behavior of its rivals who are large and small in number, and by smaller firms on the competitive fringe. Additionally, these firms (often in coalition with others) have considerable ability to influence public actions which affect the firm's environment. As a result, it is more difficult to predict their behavior, and thus to determine economic consequences, than for the more familiar market-directed firm.

Corporate Management and Productivity, Efficiency and Stability

The industrialized food system is much more productive than subsistence agriculture. The large corporation accounts for by far the largest part of the value of output of the total farm and food system. It has contributed immeasurably to the productivity of the system by performing functions in production and distribution of farm inputs and conditioning and distribution of farm products.

Available research gives us good evidence on the relative productivity and efficiency of farm operation by large corporations and family farmers. Family sized farms can achieve the available on-farm production efficiencies for almost all farm enterprises. However, the evidence also indicates that large scale farming makes it possible to gain advantages in buying inputs and in marketing products. This is associated with both size – being able to make a better bargain – and in the skills of corporate management in finance, procurement and marketing.

The major source of higher production costs for the large corporation, compared to the family farm, results from the separation of ownership, management and labor. Management and labor seek their own objectives which are often different than the owners'. This requires resources for supervision. Labor has an incentive to organize and enforce demands for better wages and working conditions. So, typically one would expect higher labor costs for a corporate farm compared with the family farm. The large corporation would be attracted to enterprises which are capital and management intensive, such as broiler production or feed lots. As farm enterprises become more capital intensive, they will become more attractive to the corporation.

Why is there the prevalence of corporate integration into farming by means of contracts rather than ownership? Because corporations can achieve their need for control of supplies and avoid some of the costs and many of the problems. The family farmer provides supervision, land, labor and other capital and the corporation avoids dealing with another union and set of work rules, unemployment taxes and significant risks. It is a relatively inexpensive means to gain control.

Corporations tend to set prices using standard operating procedures. Transfer prices for products within the corporate system, often including farm products produced under contract, are frequently set with less reference to external markets than is necessary for competitive firms. Prices are generally set as part of an overall merchandising strategy, often reflecting attempts to create unique product images by setting higher or lower prices than would be set in a free market. Because of the few firms in a market they may not be as subject to competitive forces as many small firms would be. As a result, final prices in these systems tend to reflect corporate policy and may not respond well to changes in supply and demand conditions. This reduces efficiency and effective coordination.

The impacts upon growth and stability are more mixed. The corporate management system generates stable and predictable corporate behavior, as long as earnings are acceptable. Fairly large changes in external conditions are often necessary to change corporate procedures or policy, including investment or disinvestment. That is, the corporate system tends toward stability. However, when conditions force changes in corporate procedures, the adjustment may be more abrupt and more disruptive, both in the marketplace and to farmers and others, than would smaller and more constant change in competitive markets.

Corporate managers often appear to implement policies which concentrate profits at points that pay off best for management. During non-inflationary periods this has often been in the expansion and upgrading of fixed assets. As these assets appreciate in value, managers often benefit through various stock options and similar plans upon which they can realize tax savings through capital gains. High inflation erodes the benefits of such income-deferred tax savings.

Thus, managers may be more inclined toward investments with short term, rapid earning potential which can be translated into higher salaries, bonuses, and executive benefits. Under this situation, corporate management may go slow on long run investments in productivity, and may demand concessionary policies such as tax breaks, greater market power, financial subsidies or other risk guarantees to undertake more investment.

Adaptability and Progressiveness

Corporate management generally supports research and innovation within the corporate system, which encourages progressiveness and adaptability. Size and diversity are both involved. Larger organizations simply have more funds to commit to such research. Firms that are diversified throughout the food production and distribution system have more opportunities to adopt research results. The larger and more diverse agribusiness corporations do more innovation research than do smaller firms. As these corporations integrate into farm production, adaptive and innovation research by private industry should also increase. Large corporations have introduced new technology into farming, involving large amounts of capital, such as broiler production, cattle feed lots and trickle irrigation.

However, a farm production system dominated by a relatively small number of large corporations would probably not continue to gain support for a vigorous program of public research. The net result is likely to be more rapid adoption and commercialization of new research results but slower additions to the stock of basic knowledge because the benefits of basic research are hard to capture by an individual firm.

Supply and Safety of Food

Merchandising is one of the major capacities of agribusiness corporations. They are seriously committed to supply relative standard and acceptable food products. These corporations may be motivated to gain some managerial influence over farm production to assure an adequate quantity and quality of farm commodities, consistent with their commitment to supply the consumer.

While corporate managers have no greater technical ability to reduce farm production variations caused by disease, pestilence, weather or other natural causes, they do have a fairly strong incentive to use all available techniques that assure supplies. This includes development of some excess capacity, or "organizational slack," which may be utilized inefficiently except during times of stress.

Resource Conservation and the Environment

Environmental protection and conservation are almost always public policy issues. Private firms have fairly strong economic incentives to ignore these considerations unless their competitors are also compelled to bear the same responsibilities and costs. Despite considerable rhetoric about the "good stewardship" of family farmers, government incentives have been needed to induce widespread conservation practices in family farming, and even these have been severely tested.

Agribusiness corporate managers can exercise political clout through lobbying and other political actions. This could be used to forestall environmental and conservation policies. However, with considerable popular support for such policies, it seems doubtful if many corporations would risk the poor publicity if such efforts were exposed. Rather, because there are fewer decision makers in a corporate-managed system, it may be easier to bring about voluntary compliance with environmental and conservation programs than in the more dispersed family farm system.

Equity, Social Values and Rural Communities

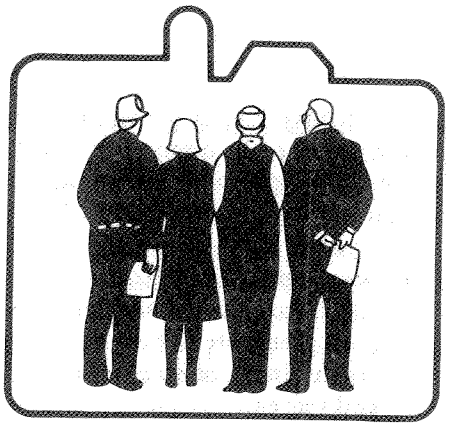
A small-firm, dispersed industrial structure, such as the family farm is not characteristic of the U.S. economy. A system of corporate-managed farms would be more consistent with other industrial sectors. Increased organization of farmers and farm laborers into trade unions for bargaining over wages and other working conditions could occur, paralleling organizational patterns in other industries. The trade union also becomes an important institution for managing work interruptions, labor alienation and employee frustration. Farmer earnings would more closely parallel earnings of other tradesmen. In this sense, a corporate managed farming system could be more equal to nonfarm sectors.

The loss of open markets for farm products and production inputs that is associated with integration of agribusiness corporations into farming means foreclosed opportunity for new operators to enter farming. Apprenticeship requirements and other rules would undoubtedly evolve to restrict entry into farmer trade unions. Whether these types of barriers would be more restrictive on people trying to enter farming than the current situation of high land costs and large capital requirements is speculative.

The displacement of local farm supply and marketing businesses by corporate integration clearly means less business activity by main street merchants in rural communities. This could spell disaster for the already perilous economic viability of many rural towns.

Final Comment

Public opinion polls show that many Americans hold nostalgia for the family farm. This perhaps reflects the Jeffersonian ideal – a fundamental belief that the family owned, operated, and managed farm is inherently good. It is not valid to assume that corporate management of farming is inherently bad. But it is inconsistent with the Jeffersonian ideal.



HOW HAVE GOVERNMENT PROGRAMS AFFECTED STRUCTURE OF AGRICULTURE?

Otto C. Doering III
Purdue University

Arley D. Waldo
University of Minnesota

> A predominance of family-sized farms enhances the dignity, productiveness, and well-being of a larger proportion of the rural population than would be possible under any other pattern of agricultural land ownership.
>
> — *Secretary of Agriculture Clinton A. Anderson, 1945*

> If we want to maintain the diversity of American agriculture, if we want to protect a place for family farming in the fabric of rural society . . . we must commit ourselves now to developing policies that will be in our best longrun interests.
>
> — *Secretary of Agriculture Bob Bergland, 1979*

The changing structure of American agriculture has gripped the attention of farmers, consumers and agricultural policy-makers.

What do we mean when we talk about the structure of U.S. agriculture? Broadly speaking, we are referring to the number and size of farms, the ownership and control of farm businesses and agricultural resources, marketing arrangements concerning farm inputs and agricultural products, and the freedom of people and resources to move into and out of the farm sector.

For nearly half a century we have seen a decline in farm numbers and an increase in farm size. Fewer large farms are producing a greater proportion of total output. In 1960 the largest 21 percent of the nation's farms produced 73 percent of total output. In 1978, with one-third fewer farms, 22 percent of all farms produced 81 percent of the total production. Moreover, the largest 63,000 farms accounted for about two-fifths of all farm sales in 1978. For certain commodities and enterprises – e.g., cattle feeding, broiler production, sugar cane, processed fruits and vegetables, seed production, and citrus fruits – farm production has become highly concentrated, and this emphasizes the overall trend.

Government and Agriculture

A dominant theme in the development of American agriculture has been the Jeffersonian ideal of the "family farm" and its fundamental importance to the American political system – the belief that the family farm is the "backbone of democracy."

Over the course of 200 years, government policies toward agriculture have been heavily oriented toward maintaining and strengthening the "family farm." A committee representing all federal agencies concerned with agricultural policy stated in 1940 that:

> The U.S. Department of Agriculture believes that the welfare of agriculture and the Nation will be promoted by an agricultural land tenure pattern characterized by efficient family-size owner-operated farms, and one of the continuing major objectives of the Department will be the establishment and maintenance of such farms as the predominating operating farm unit in the United States.

In 1940 we had more than six million farms, today we have fewer than one-half that number. Has something gone wrong? Or does the trend toward fewer, larger, and more specialized farms over the past 40 years represent a desirable change in American agriculture and our rural communities?

...state and local governments are adopting policies which affect the structure of agriculture...

Government policy has influenced the development of U.S. agriculture since the founding of the nation. But direct government intervention to improve farm prices and incomes began with the passage of the Agricultural Marketing Act of 1929 and a barrage of depression-fighting measures in the 1930s. Most of our current agricultural policies were born out of the experience of the agricultural depression of the 1920s and Great Depression of the 1930s. The politics of farm programs were expressed in terms of providing adequate income and work to keep those in agriculture gainfully employed.

During the 1950s and 1960s U.S. agriculture underwent a major scientific and technical revolution that led to vast increases in output per input of land and labor. At the same time, U.S. industry was able to provide non-farm jobs for many farmers and farm residents. These events created a different environment for agriculture from that of the depression period in which the initial basis for farm policy was formed.

Government policies usually interact with one another, and also with events and forces that are beyond

direct government control. Their effects are intertwined with the effects of other policies. Some policies may reinforce one another, others may have conflicting effects. Moreover, while we tend to think most often of federal farm policy, state and local governments are increasingly adopting policies which directly affect the structure of agriculture. We have to view specific programs in this context.

Commodity Programs

There are two general ways of attempting to increase farm income. One is to make direct income payments to farmers and let the production and pricing of commodities be determined in the free market. The other approach is to increase commodity prices by controlling farm output and expanding the demand for agricultural products. Both of these techniques have been a part of the U.S. farm policy since the thirties.

...commodity programs have helped the big farmer more than the small farmer...

Broadly speaking, the most politically acceptable means of supporting the incomes of farm families has been through programs to support commodity prices in the marketplace. With price supports, each producer gets a price that is a bit higher than it otherwise would be. But the total benefit to an individual producer depends on the amount produced, and the additional returns generated by the program may not be concentrated where they are most needed. Low-income farmers, for example, tend to operate small farms and to have low yields. A farmer with a small volume will get only a limited amount of income assistance as compared with a farmer producing many times as much.

Another feature of price support programs is that they provide direct assistance only to those producers who grow and market price-supported commodities such as wheat, feed grains, and cotton. Those who specialize in enterprises for which there are no price supports, especially livestock producers and those who market livestock, are not benefited directly.

There are a number of other programs, such as disaster assistance and crop insurance, where program benefits are tied to the volume of production.

Because of the linkage between benefits and volume, commodity programs have helped the big farmer more than the small farmer. This may not have been the intent, but a policy of aiding farmers by supporting commodity prices means that those producing the most receive the most benefit. To the extent that government programs helped to stabilize farm prices, they probably encouraged expansion in farm size and increased specialization through reduced risk. Attempts at avoiding this outcome by providing minimum acreage allotments and placing ceilings on the direct payments that a farmer may receive have not been very effective.

Commodity programs also have had some important indirect effects on the farm sector. As commodity programs increased the price of a particular commodity, they also brought about an increase in the value of the land that could grow the government-supported crop. The value of the program was capitalized into the price of land. This was beneficial to farmers owning land at the time the program was implemented, but new entrants into agriculture found any increase in commodity prices offset by increased land prices.

...those producing the most receive the most benefit...

Commodity price support programs also did little to break the technology treadmill that was a part of the scientific revolution in agricultural production in the 1950s and 1960s. When a new production-improving discovery was introduced, the first farmers adopting it would get increased yields and higher profits. But as more farmers adopted the new practice, total production would increase. This would result either in a lower price for all farmers or an attempt by the government to limit the volume of production.

All in all, commodity programs were not very effective in raising the incomes of those farmers who might need the most assistance. The programs increased land prices and could not overcome the downward pressure on commodity prices resulting from scientific advances which increased productivity in the 1950s and 1960s.

Credit Programs

Government assistance in farm credit markets began with passage of the Federal Farm Loan Act of 1916. This law served as the foundation for what is now a user-owned system of credit for real estate and operating loans to farmers and loans to farmer cooperatives. Special farm credit programs were also established in reaction to the mass farm foreclosures and other problems of the depression in the 1930s.

What impact has the availability of credit had on the structure of agriculture? Some government credit programs – those of the Farmers Home Administration and, more recently, the Small Business Administration – are targeted toward low-resource farmers. But questions are being raised about decisions of creditworthiness made by other government-sponsored farm credit agencies. Some people argue that government "bankers" have been no more willing than their private sector counterparts to take a chance on small operations or persons attempting to enter agriculture.

The degree of appropriate risk taking is not easy to determine because even farm credit agencies have to maintain their financial solvency. They cannot play a high-risk rescue role. However, if federal credit agencies are supposed to play a more socially active role in keeping families in agriculture, some guidelines are needed.

Federal lending institutions sometimes appear to be the price-setters in land sales – often willing to lend more on a piece of land than private banks. Once a loan value has been set by the most expansive creditor, it becomes a question of which neighbor has the extra several hundred dollars per acre above the loan limit that is needed to clinch the sale.

Higher land prices have had a significant impact on who can afford to purchase and hold land. A decade ago, if an individual had a 25 percent downpayment for quality Corn Belt land, the cash flow from that land would support the mortgage on the remaining 75 percent. Today, an individual needs a 50 percent downpayment in order for the cash flow from that land to support the mortgage on the remaining 50 percent.

The effect of government-sponsored credit programs on the structure of agriculture is mixed. Credit made available by the Federal Land Banks, production credit associations, and other financial institutions may have contributed to a shift toward fewer and larger farms. At the same time, farm loan programs of the Farmers Home Administration and the Small Business Administration, aimed at farmers with limited resources and those affected by disaster, may have helped slow the reduction in farm numbers and the concentration of the ownership of agricultural resources.

...the value of the program was capitalized into the price of land...

Intervention in farm credit markets is not limited to the federal government. A few states have begun programs to make credit more available to beginning farmers. If these programs become more wide-spread, they could have a significant effect on new farm operators.

Tax Policies

Federal and state tax policies toward agriculture have undoubtedly affected the structure of U.S. agriculture. Many tax law provisions which allowed investors outside of agriculture to shelter large amounts of income by investing in agricultural enterprises have been eliminated in recent years. But present tax rules still provide liberal benefits for farmers and those who invest in farming.

One tax provision that benefits farmers is the option of cash accounting for tax purposes. This rule simplifies tax accounting for farmers and makes it possible for farmers to reduce year-to-year fluctuations in taxable income, thus reducing their tax liability. Provisions for cash accounting are especially beneficial to large, high-income producers.

Large operators also gain a distinct advantage because of capital investment rules, particularly those concerning depreciation. If an identical piece of equipment is purchased by high and low tax bracket farmers, the after tax cost of the equipment is lower for the farmer in the high tax bracket. Since interest payments are deductible expense items, those who are in a high tax bracket receive another advantage. Both of these factors provide an incentive for higher income (and probably larger) farm firms to increase capital investment and have resulted in increased productivity for many.

Land Policy

National land policy, especially in its early form under legislation leading to passage of the Homestead Act, was designed to encourage the settling and maintenance of a large number of moderately sized agricultural units. Once the frontier was closed, the encouragement of continued production by small dispersed units would have required specific public action. As we further expanded our agricultural land base to marginal lands through intensive investment in irrigation and land reclamation, there was no government policy to limit the concentration of holdings often accompanying large investments in new and highly productive technology.

There also has been no federal restriction on land purchases by foreign investors, although some states have now enacted such measures. This is partially because we have to allow foreign purchases of our capital assets if we are unable to sell as much in the world as we want to purchase. Our extreme demand for oil, for example, has resulted in more imports than exports, so we must sell something to redress the balance.

Research and Extension

Why should the public invest in research and education in agriculture? Few individual farmers could afford such investment given the concentration of resources, trained personnel and scientific hardware required today. Private investment is usually made for profit, and many advances in agriculture are such that they cannot be patented or licensed and it would be difficult to charge a fee.

Ultimately, the major benefits from improvements in agricultural technology fall on the public in the form of larger supplies and lower food prices. But the public has not appeared to notice the benefits of agricultural research and extension. When the benefits have been calculated they have been extremely high – in most cases returns to agricultural research are greater than 30% annually.

Some farmers believe that the public receives too great a share of the benefits from improved technology. They believe that they would be better off producing less at higher prices. Research puts them on the technology treadmill. To compete with each other they are forced to adopt improved practices – only to face lower commodity prices because of increased supplies.

Agricultural research and extension are sometimes given the credit (or blame) for the increase in farm size and decrease in farm numbers. Much of the new technology has not only increased agricultural productivity, but has also increased the optimum size of farms. As an example, more productive and larger farm equipment makes it possible for the farmer to cover more land. As a corollary, the farmer has to cover more land if he is to be able to make the new equipment pay.

...agricultural research and extension have high payoff...how are these benefits shared?

We know that agricultural research and extension education have high economic payoff. The real question is: How are these benefits shared? Do consumers capture such a high proportion of the benefits from research and extension that farmers are left with less than before given the effort they must make to modernize and adapt? Do large farms benefit more than small ones?

Nonfarm Policies

In addition to the programs intended specifically for agriculture, the general economic policies of the federal government have had a significant impact upon farming. The Employment Act of 1946 and other government policies that stimulated economic growth provided the jobs that were filled by those migrating from rural areas. The substantial reduction in the number of farms and farmworkers could not have taken place unless the nonfarm jobs were available. The increase in nonfarm jobs also enhanced the economic opportunities for those remaining in rural areas, and today nonfarm employment provides a needed source of family income for many small part-time farms.

Federal monetary and fiscal policies influence agriculture. Inflation in recent years has not only increased farm operating costs, but also contributed to higher land prices as investors have sought a hedge against inflation. While farmers might have benefited from inflation in the past, this no longer seems to be true. Bringing inflation under control and reducing unemployment is as important to farmers as it is to other groups.

Agriculture is also affected by many other policies — for example, trade policy, programs to protect the environment, energy policy, etc. — all of which may affect the structure of farming.

Concluding Comment

Many different government programs and policies have influenced the changes that have occurred in the structure of U.S. agriculture. Their effects have been mixed. Some have contributed to farm enlargement and a reduction in farm numbers. Other policies have helped slow down the trend toward fewer and larger farms. If we are genuinely concerned about the structure of American agriculture, we need to examine government policies in a new light. As the Secretary of Agriculture has observed, "We have few programs today that deal specifically with farm structure and no comprehensive policy on the subject at all." Perhaps a structure policy is needed. Or perhaps we just have to think more explicitly about the likely effects of any policy on farm structure before deciding on its merits.

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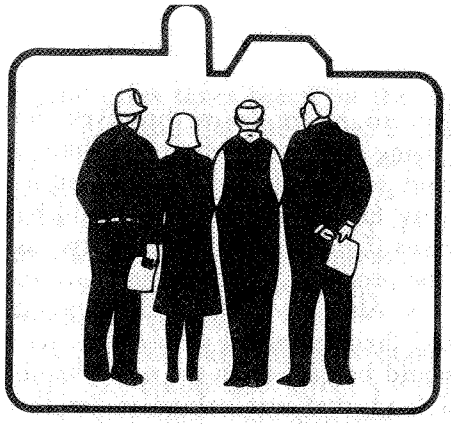


HOW DO INCOME, ESTATE AND GIFT TAX POLICIES AFFECT STRUCTURE?

Harold D. Guither
University of Illinois

Donald L. Uchtmann
University of Illinois

Federal income, estate and gift taxes can affect the structure of U.S. agriculture. Farm owners and operators and the major farm organizations have succeeded in getting some changes in past policies.

Income taxes became a permanent part of the tax system during World War I. For many years most farmers' incomes were low enough to escape income taxes. During and immediately following World War II, income taxes began to affect more farmers. In recent years, cash accounting, investment credit, and capital gains tax rates provide special benefits for larger farming operations and are believed to be a major influence in expansion of many farming operations.

This report will emphasize the income tax on capital gains and the cost basis of property, although there are many other tax provisions which affect the size and structure of farming operations.

Estate taxes became a permanent part of the federal revenue system in 1916. Gift taxes are closely linked with estate taxes and prevent holders of large estates from giving away their property to completely avoid estate taxes. As inflation occurred and property values increased, more and more farmers' estates became subject to taxes. Consequently many farm groups joined together to press for increased exemptions and other special estate tax treatment for family owned farms enacted in the Tax Reform Act of 1976. The 1976 Act also created a single schedule of gift and estate tax rates and credits.

Income, Estate and Gift Taxes Influence Structure

Taxes have three main purposes in our society: (1) to raise revenue, (2) to redistribute wealth, and (3) to direct the course of society. Income, estate and gift taxes contribute toward achieving all of these purposes.

Since estate and gift taxes do apply to farm property, they affect the size of farms, the amount of landholding by nonfarmers, and the decisions to place some land on the open market. More specifically, estate and gift tax policies influence (1) retention of farmland ownership in the family, (2) who in the family owns farmland, (3) the business organization and tenure arrangements of the farm operation, and (4) the value of farmland.

Ownership Retention in the Farm Family

Special or "use" valuation. Probably the most significant policy change that will influence the structure of agriculture for many years is the special or "use" valuation provision in the Tax Reform Act of 1976. Special or "use" valuation was provided in Section 2032a of the Tax Reform Act of 1976 for family owned farms and other closely held businesses. This new policy gives special incentives to hold and manage farmland in the family. The purpose of the policy was to keep family farms intact, but an increase in acquisition and holding of farmland by families not currently holding farm property can also be expected because of the tax advantages involved.

TAX POLICY CONSEQUENCES

Cash accounting, investment credit, and capital gains tax rates provide special benefits for larger farming operations and influence farm operators to expand.

The major incentive for farmers to incorporate and form family farming corporations is the income tax savings.

Older farmland owners are encouraged to hold farmland until they die since there will be no taxes on the gain in value – only a tax on the net value of their estate.

Special or "use" valuation in filing estate tax returns, will encourage families owning farmland to retain ownership of the land. Land holding families will save substantial estate taxes and increased funds will be transferred to heirs.

"Use" valuation will reduce the amount of land sold to settle estates.

Wealthy persons may be encouraged to buy farmland to take advantage of estate tax savings under the "use" valuation provision, if they can qualify.

Special leasing arrangements and documentation may be set up so that certain families can qualify for estate tax savings under use valuation and deferred payment of estate taxes.

Older farmers may be able to outbid younger farmers for a tract of land because of estate tax benefits under the special use valuation provisions.

Gift tax provisions encourage transfer of farm property to family members over a period of years and will usually result in dispersed ownership of farm property among family members.

The tendency over time will be to move land ownership into the hands of those who can qualify for use valuation under the 1976 Tax Reform Act.

The use valuation provision enables heirs of farm property to receive considerably more net proceeds from those estates that qualify. An Iowa study revealed that the use valuation amounted to 31 to 43 percent of the farm market value on farm real estate in central Iowa. An estate worth $500,000, comprised of about 50 percent real property, and taking advantage of the use value provision could yield about 14 percent more net proceeds for the heirs than with market valuation.

...use valuation may help those already owning land but may make acquiring land difficult for non-owner farm operators...

The maximum allowable reduction in value of the estate is $500,000; so benefits under this provision increase as the size of the estate goes up to the point where the maximum allowable saving can be achieved. With the maximum saving set at one-half million dollars, there is a special incentive to save more taxes by building larger estates with half of the value in real and personal farm property. Use valuation not only results in tax savings, but also reduces the need to sell land to pay the taxes. It can increase substantially the amount of property transferred to the heirs, will tend to keep farms in those families now owning farmland, and reduce the opportunity for those who want to buy farmland through purchases on the open market.

The use valuation provision provides qualified heirs with a means to accumulate capital and retain it in farmland. Parents like it since it provides a means for their children to accumulate capital in a way that they could not do previously.

However, several requirements must be met to qualify for the special use valuation: (1) the real and personal property used in farming and passed to members of the family must comprise at least 50 percent of the adjusted estate; (2) real property (buildings and land) used in farming and passing to qualified family members must comprise at least 25 percent of the adjusted gross estate value; (3) the decedent or a member of the decedent's family must have owned the real property and must have materially participated in the management of the farming operation for five of the eight years preceding death; and (4) a member of the family must continue to operate or materially participate in the operation of the farm for 15 years following the death of the owner. Otherwise all or part of the tax savings must be repaid.

Stepped up basis is another tax policy that influences farm structure and retention of land in the farm family. Although most farmland has greatly increased in value during recent years, the owner will have to pay no tax on the gain in value if he or she holds it until death. Congress tried to change this law in the Tax Reform Act of 1976 to a "carryover basis" but a return to the "stepped up" basis was made in 1980.

The result is that sales of farmland by older landowners are discouraged since they can escape the tax on capital gain by not selling before death. The estate of the decedent is subject to estate taxes, however. So farmland, rather than being sold, is held for the heirs.

The heirs of farmland receive the cost basis used in the estate valuation. Any future capital gains would be calculated from this basis if they sold the property. As long as the heirs hold the property, they will not have to pay any capital gains tax. Also, by receiving the stepped up basis, heirs who sold their farmland would have less gain on which they would be taxed. On the other hand, if heirs sell inherited land that was valued under the special valuation provision, they will usually pay more capital gains tax than if the market value had been used when the estate was settled.

Stepped up basis may influence decisions two ways: for those heirs who cannot qualify for use valuation, they may be encouraged to sell property after the death of the owner so they can escape the capital gains tax; for those heirs who qualify for special or use valuation, they will be encouraged to hold their property within the family. The net tendency over a period of time will be to move land ownership into the hands of those who can qualify for use valuation under Section 2032a of the 1976 Tax Reform Act.

Deferred payment of estate taxes, now permitted for estates made up of at least 65 percent of farm or closely held business property, is another policy that encourages retention of land in the farm family. Up to 10 installment payments of the deferred tax can be made starting no later than the sixth year following the owner's death. A special four percent interest rate is allowed on the deferred tax on the first $1 million of farm business property. For those who can qualify for deferred payment of taxes, few if any farms would have to be sold to meet estate tax payments.

Influencing Who Owns the Farmland

Policies most likely to influence who in the family will own farmland are those dealing with gift tax exemptions, special use valuation, and generating skipping exemptions.

The Tax Reform Act of 1976 did not change the earlier provision that permitted tax free gifts of any kind of property up to $3,000 per year per person to any number of persons. Husband and wife together could make tax free gifts up to $6,000 to any number of persons. Consequently, those landowners who want to reduce estate tax liabilities, may plan a transfer of their property to family members over a period of years. The result is to encourage a dispersed ownership of property, usually among all members of the family.

Special valuation could also influence who in the family owns the land. In many families, one family member operating the family farm can easily qualify the farm for use valuation when the owner dies and the next generation takes over. Some of the new owners will not be farming or have direct farm interests. But to sell their share of their inherited land would require them to pay

capital gains taxes based on the difference between the use value and the sale value. If the tax on such sales is high, some family members will delay selling and dispersed ownership among the family members could continue for many years. If they do sell, they could sell to another qualified family member to avoid "recapture" of estate taxes that would be due if sale was made to a non-family member.

Generation skipping provisions of the 1976 Tax Reform Act could also affect who in the family acquires farm ownership. This provision involves the owner leaving a life interest to children as long as they live and then a remainder interest to the grandchildren. This arrangement avoids inclusion of the income producing property in the estates of the children when they die. However, the tax saving is limited, because of the new special generation skipping tax which taxes non-exempt life interests as if the income producing property were included in the children's estates. However, the special generation skipping tax exempts the first $250,000 of income producing property for each child with descendents, so providing a life income interest to children does save some estate tax at the death of the child. For a family farmer with large land holdings and several children and grandchildren, substantial value of farmland could be passed to his children in the form of life estates and remainder interests to grandchildren, spreading the ownership interests and saving estate taxes for his children.

Effect of Tax Policies on Business Organization and Tenure Arrangements

Incorporation of family farming operations has occurred with increasing frequency in recent years. Tax savings have been the major incentive to shift to the corporate form of business organization. Accumulation of capital is also encouraged.

For many farming businesses, income tax savings are the major benefits to incorporation. The corporate tax rate of 17 percent of the first $25,000 of net income increasing gradually to 46 percent on earnings over $100,000 is a lower rate than the individual would have to pay on the same amount of income. At the same time, certain expenses such as an employee's health and accident insurance can be a business expense for a corporation but could not for the individual.

Estate tax savings may also be achieved through incorporation. Parents who own land and other farm property can reduce the size of their estate through tax free gifts of corporate stock of up to $3,000 per person per year. However, other means of tax free gifts can also be arranged.

Tenure arrangements are also affected by tax policies. To qualify for use valuation under Section 2032a, a farm owner or a member of his family must be materially participating in the management of the farm for five of the eight years prior to the death of the owner. Following the owner's death, at least one of the heirs to the property must also materially participate in the operation of the farm.

For many farm families, there will be no problem in qualifying as material participants in the operation of the farm. For others who are renting the farm to a non-family member, special leasing arrangements and documentation are required to qualify.

The payment of estate taxes over 15 years also provides a significant incentive for a farmland owner approaching retirement to form a corporation or a partnership. The benefits of the tax deferral will not be available to a sole proprietor who is not *actively* involved in the farming business. If a partnership or corporation is involved, the 15-year deferral will automatically be available if the partnership contains fifteen or fewer partners, the corporation contains fifteen or fewer shareholders, or the decedent's share of the partnership or corporate voting stock equals or exceeds 20 percent. In effect, a partner or a principal shareholder can retain eligibility for the 15-year deferral even though that person ceases to be actively involved in the business while a sole proprietor must continue active involvement to retain eligibility. There is often a very significant incentive for creating a partnership or a corporation.

Tax Policies Affecting Land Prices

The 1976 Tax Reform Act substantially changed the valuation procedure for farm real estate in calculating federal estate taxes. The net result is a decline in farm estate values for tax purposes. So as individual farmers grow older, they may shift more of their capital investments into land and away from non-land assets, at least up to the point where maximum reduced valuation of $500,000 is achieved.

The use valuation provisions could enable older farmers to outbid younger farmers for a particular parcel of land, based on the value of the tax benefits each would receive. The bid price for farm real estate would be expected to rise by the amount of the present value of such tax benefits to the bidder. On the other hand, the death tax cost will arise sooner for older farmers than for younger farmers.

Benefits of this new provision will probably be capitalized into farmland values as farmers, with family heirs who plan to continue farming, bid land away from other potential buyers.

This estate tax shelter may also provide an incentive for movement of more tax-motivated capital into farming. Some observers actually see the use valuation provisions for estate tax purposes as a powerful incentive for individuals to minimize their federal estate tax by buying farmland. Although Congress attempted to safeguard these provisions by passing restrictions on the use of these farm preferences, some may be able to overcome these restrictions with long-range planning.

Bidding up the price of land could be expected to the extent the person's investment in land would not produce the maximum reduction of Federal gross estate of

$500,000. Those with sufficient investment in land to qualify for the maximum reduction in gross estate would be expected to maintain investment position in land sufficient to assure the maximum tax savings.

The encouragement for many to increase investment in land to assure the maximum reduction in tax would be expected to generate upward pressure on land prices, although the net effect might well be modest because many older farmers already have substantial investment in land.

For investors who do not own farmland, or other land eligible for use valuation, the impact on investment behavior could be much greater than for farmers. The major impact on the land market would also be affected by the number of investors who could meet the pre- and post-death requirements for use valuation of land.

Both use valuation and deferred payment of estate taxes will make it possible for some families to retain ownership of more land rather than being forced to sell some to meet estate tax obligations. Less land coming onto the market would also be an upward influence on prices and keep land in possession of the families now owning land.

Summary and Conclusions

Tax policies designed to help individual farmers can be of significant benefit to those who hold farmland but they may not be beneficial to farmers as a group. Such policies which help present owners offer no benefits or may be detrimental to those who do not own but want to buy land.

If the major objective of income, estate and gift tax policies is to protect and preserve the family farm, the provisions for use valuation may help those families who already own land to keep it but may make acquiring land difficult for non-owner farm operators who want to buy it. The result is continued and increasing control by land holding families.

Land ownership and farm structure are closely related and policies concerning one generally cannot be changed without affecting the other. Tax policies as described in this paper have a major influence on who will own farmland in the future. And who owns the land will determine the type of farm organization, numbers and size of operations, and the available opportunities for beginning farmers.

Policies which encourage specific forms of farm business organization such as corporations, will also influence growth and concentration of land, capital, and technology into larger-than-family farm operations.

TERMS DEFINED

Capital gain—The gain in value realized when a piece of property is sold – the difference between the price paid and price received. Capital gains are taxed at lower rates than ordinary income from employment or business.

Estate taxes—Federal or state taxes levied upon the net value of property owned by a person who dies. Estate taxes are levied against estates; inheritance taxes are levied by certain states upon the value of property received by each heir.

Stepped up basis—When a person dies and owns property that has increased in value during his or her lifetime, the property that has increased in value is given a "stepped up" basis, the value at the time of the owners' death. No capital gains taxes are levied on the gain in value against the estate.

Carryover basis—The Tax Reform Act of 1976 attempted to tax the increased value on property when the owner died by setting up a "carryover basis." The heirs would carry over the basis, or cost, of the deceased owner and when they sold it would be subject to a tax on the gain – the difference between the market price and the carryover basis. This provision was repealed in 1980.

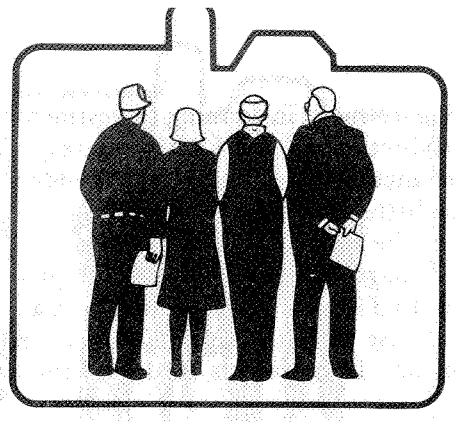
Decedent—A person who dies.

Deferred payment—The Tax Reform Act of 1976 permitted heirs to defer payment of estate taxes on certain farm property if proper qualifications were met.

Use valuation—Special or use valuation was a provision in the Tax Reform Act of 1976 which made it possible to value farm property and other closely held business property in the estates of deceased persons based upon its "use" value rather than its market value. Use valuation of farm property involves a formula based on rental income and average farm mortgage interest rates.

Life interest—Persons may inherit a life interest in a piece of property which gives them full use of and income from the property during their lifetime but they cannot sell it. When this person dies, the possession and use passes to another person who has been designated to receive the property, sometimes called the holder of the remainder interest or remainderman.

Remainder interest—A future interest in property where possession and use will pass to the holder after the death of the life tenant. Nevertheless the holder of the remainder interest holds legal title even during the possession by the life tenant.



HOW DOES INFLATION AFFECT FARM STRUCTURE?

Otto C. Doering III
Purdue University

Federal farm policy has been important in shaping farm structure, the size, concentration and ownership of farm firms. However, farm policy is not the only factor affecting the structure of agriculture. Inflation has been a major force in shaping U.S. agriculture, and unless the course of high inflation is modified, it will continue to be a strong influence.

To illustrate the impact of inflation on the farm business consider the purchase and operation of a farm when inflation is at 9% and when inflation is zero. In both cases start by borrowing the full purchase price of the farm at the interest rates that might prevail under no inflation and at the interest rates under high inflation.

Illustrated Cash Flow with Initial Full Land Cost Financing

	Inflation Rate	
Returns (as a percent of farm equity)	*0%*	*9%*
Current Earnings	4%	4%
Deferred Earnings	*0%*	*9%*
Total Returns	4%	13%
Current Cash Flow		
Current Earnings	4%	4%
Mortgage Rate	3%	12%
Current Surplus (Deficit)	1%	(8%)

Although current earnings are the same in the first year with or without inflation, under inflation the value of the land is expected to go up at least as fast as the inflation rate. The land owner receives this gain, but it isn't received until he sells his farm. The critical thing to notice in the example is the cash flow in times of inflation as compared with a period of no inflation. Inflation imposes a cash flow deficit on those who must borrow to finance their major assets during inflationary periods.

Inflation also forces the farm owner to defer earnings. This has begun to happen already. Whether farmers want it or not, an increasing proportion of their total return from farming is coming to them in the form of increased property values during inflation. If we look at the total net returns to farmers, in the 1960s, about 80% of these returns were in the form of direct net income and 20% were in the form of increased land values. In the middle of the 1970's only 55% of the total returns were direct net income, while 45% were in the form of increased land values.

All farmers are not equal in their ability to defer a portion of their current income and continue farming. In addition, the increased proportion of the total return coming from land appreciation makes the ownership and control of the land a much more critical issue.

What are some of the effects of such inflation related cash flow squeezes on farm structure? Insofar as farm real estate is concerned, prolonged periods of inflation make it difficult for some to own farmland. Those who could purchase farmland during such periods would need enough farm business volume already to stand the current cash flow deficit. Alternatively, they might be individuals who hold jobs in addition to farming and could "carry" their farming operation with the outside income they earn. In this sense, we might see large farms getting larger through the purchase of additional land, and we could see part time farmers getting more numerous as they are willing to support farmland purchases with outside income. The operator of the moderate sized family farm would be squeezed. This would be a farm just large enough to support a family with income from the farm, but with little cash flow left over to get into farming under such conditions or to support the purchase of additional land.

...inflation has made investment in farming a high stakes game of chance...

Landownership is also a hedge against inflation for off-farm investors. An outside investor who is able to cover the cash flow and willing to defer income would be a likely purchaser of farmland during inflationary times if the value of the land increased at or better than the rate of inflation. The outside investor looking at this as a hedge against inflation will also have the advantage of receiving his deferred income taxed at capital gains tax rates rather than at the higher current income rates.

Inflation is also likely to cause changes in the way that farms are organized. Inflation tends to push individuals into higher tax brackets. This can be incentive enough to cause some farmers to incorporate so they are then taxed at the lower corporate rates.

Inflation is also at the root of increased concern about intergenerational transfer of farms. As the farmland – the basic capital asset of the farm – goes up in

value, the problem of passing the farm on to a younger generation within the family becomes greater. First, the inflated value of the land pushes the estate into higher tax brackets. Second, if the younger generation has to finance the purchase of the farm from other heirs or borrow to pay estate and inheritance taxes, the new owners are in the same difficult current deficit situation as the person who has to borrow to buy land during inflationary periods.

When inflation occurs, some prices may increase faster than other prices for reasons which may have little to do with the long term productive value of such assets. A farmer tends to use inputs of land, labor, machinery, chemicals, etc., in proportion to how much each one contributes relative to its cost. A period of rapid inflation results in the suppliers of these inputs changing their prices as quickly as possible to reflect changes in their own costs or the fact that the input, such as land, has become a good hedge against inflation. A farmer may be confronted with rapid shifts in the relative prices of inputs. For example, a 30 to 40 percent increase in the price of potash and phosphate during the period when such nutrients are applied leaves little opportunity to evaluate the impact of the price increase and whether there ought to be an adjustment in the application rate.

What we see from these periods of inflation is added uncertainty and added financial pressures for farmers attempting to cope with the inflation induced instability. Under such circumstances larger and more financially secure farmers have a built-in advantage and are likely to absorb smaller farmers who can't survive.

In an inflationary period, success may be largely dependent upon how successful one is at predicting the future rate of inflation – and this talent may bear little relationship to one's ability as a farmer. As in any period, there were a number of farmers in the early 1970's who went deep into debt to purchase farmland. This group grew larger than usual during the high prices following 1972 and 1973. Since then, the rates of inflation have exceeded any expectations.

However, the rate of inflation can slow down. Young farmers are purchasing land today with the expectation that inflation will continue to increase, the value of their land will go up, and they will be able to pay for their land in dollars that are worth less. If the rate of inflation does not continue to increase, those out on a limb today will continue to be in a bad position. If the rate of inflation decreases and the price level declines, those out on a limb could be under greater pressure by having to pay both interest and principal in dollars that may be worth more than the dollars they borrowed. Under such conditions farmers with financial security may be motivated to make additional investments if they feel they can predict inflation rates. Smaller farmers, or those just getting started may have to race hard just to maintain living standards, particularly as they cannot afford too much deferred income.

Inflation has made investment in farming (investment in the basic food production of the United States) a high stakes game of chance. An element of risk is added to agriculture that has little to do with the ability to be an efficient producer of the nation's food supply.

Inflation has also damaged the institutions that provide financial services to farmers. Society has increasingly demanded that these institutions play a role in reducing risk in agriculture. Inflation has weakened their ability to do so.

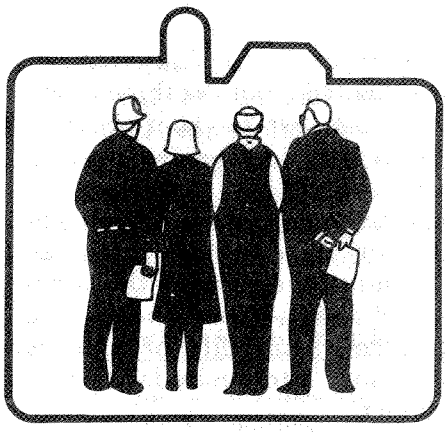
Private local banks find deposits drying up as funds are attracted to money market funds and are in a poor position to compete for funds in money market centers on a short term basis. Their conservative portfolios of federal obligations lose much of their capital value during periods of high interest rates, so they are reluctant to take these losses to raise loanable funds. The phasing out of interest rate regulations will provide a better break for depositors, and allow the costs of money to adjust to inflationary pressures.

The federal farm credit system, created especially to bring low cost stable supplies of credit to agriculture, is finding that farmers' attempts to survive inflation are increasing its exposure to risk. Today, farmers are refinancing their short term debt with the federal land bank system by taking on long term obligations based upon the inflated value of their farmland. This puts the farmer into the very severe cash flow position outlined earlier. It also makes the farm credit system dependent upon increasing land values to keep the whole system from collapse.

In the past, farmers have not viewed inflation as something to be feared or combated. Modest, steady rates of inflation allowed the farmer to come out a bit ahead in real terms on long term debt. In the short run, rapid inflation at increasing rates may enhance the farmer's net worth, enhance the ability to borrow and make last year's speculative land purchase look like a wise investment. The question is whether the rapid and increasing rate of inflation will continue. In this case the fear of inflation is a double fear. One fear is that inflation will continue, the other is that it might end.

Over the longer term, the instability brought on by inflation is likely to encourage the development of increasingly large sized farming operations and greater attempts by the farmer to control his inputs, influence his markets and diversify to avoid risk. The individual who would buy or operate a farm of moderate size just to provide the family with a living will not be able to compete for land against the larger operations or the part time farmers who can finance their negative cash flow from other earnings.

The impact of inflation on farm structure should not be ignored by farmers even though it may be ignored by those who benefit from inflation or by policy makers who see little political advantage in taking on such a difficult issue.



HOW DO PUBLIC POLICIES AFFECT BEGINNING FARMERS ?

Coy G. McNabb
University of Missouri

Martin K. Christiansen
University of Minnesota

If the family farm is to survive, more young people who have the talent and dedication will need to become family farmers. But this does not suggest that everyone wanting to farm should be enabled or guaranteed the right to do so.

Most of the obstacles to young farmers entering family farming relate to the large capital requirements and especially to the difficulty of acquiring land.

Inflation encourages land owners, whether resident or absentee, to hold onto their land. Tax policies make it possible for high income individuals to outbid the beginning farmer for land. It is difficult, if not impossible, for the low equity young farmer to have a favorable cash flow if he buys land.

Historically, most of U.S. agriculture has been characterized by farmers who own and operate their own land. There has been a trend toward very large and highly specialized farm units and away from the traditional family farm. Family farms, although widely acclaimed and supported in practically all agricultural legislation, have felt the pressure of inflated land costs and of public policies working against them.

The Family Farm Defined

A family farm is one that combines labor, management, and land ownership. The family farmer may not own all of the land operated, but owns some of it. Lifelong tenancy is not considered as a family farm. Acres are not a good measure to define the family farm because of the wide variation in soil type, climate, farm enterprises, and geographic location. A much better guide is the amount of labor required. One and one-half to two-man years of labor supplied by the farm family with no more than an equal amount of hired labor sets a reasonable upper limit. And to this should be added: there must be sufficient size and volume of business to provide an acceptable level of living, and open markets must be utilized. An integrated broiler operation is not a family farm as defined here.

If a family farm agriculture is to be maintained, some way must be found for the beginning farmer to gain entry to farming. This does not mean that it is essential to buy land at the very beginning. At the start, some farmers may find that adequate operating capital and acquiring modern machinery and equipment is a more productive way to use their limited resources than is investing in land. But as our definition states, and as the family farm concept requires, sooner or later ownership of land can and should come into the picture.

Some programs to assist beginning farmers in acquiring land are already in place in a limited way, notably the special lending by the Farmers Home Administration. Some states, such as North Dakota and Minnesota, have programs to aid the entry of young farmers, although their programs are limited in scope. If present trends continue, it is possible that young farmers will be able to enter farming as family farmers only if provided special assistance.

This leaflet takes a brief look at some aspects of starting farming as a family farmer, as a worker and manager and as a supplier of capital. Two policy areas that have affected opportunities to get started in farming are then outlined. These are tax rules and inflation. Finally, some programs of direct assistance to beginning farmers are summarized.

Entry as Family Farmer

Getting started as a family farmer has grown more difficult because of sharply rising requirements for capital – capital for land, and capital for machinery and operating expenses. It is now very difficult for even the most qualified young farmer who does not inherit land and operating capital to enter farming.

It is much easier for a person to work for corporation agriculture or become a tenant farmer than to establish a family farm. A worker in corporation agriculture would enter as a wage worker and would need the necessary skills. If the firm were unionized, it would be necessary to conform to union rules. But no finance capital would be required.

Likewise, in a tenant-landlord agriculture, the operating farmer would need no capital to buy land. He or she would require funds for machinery and equipment as well as for operating expenses. In a few leases, how-

ever, even a portion of those capital requirements is provided by the landowner.

In family farming, by contrast, where the farmer plays the multiple role of worker, manager, and supplier of capital (including capital for land), sizable obstacles now make entry difficult.

Entry as Worker and Manager

Entry as worker and manager has been essentially free of barriers. In farming, unlike various professions, there are no licenses, no union rules, no legal barriers to entry. The rare exceptions are confined to marketing of certain products under contract or cooperative agreement.

Entry terms for the individual have been their personal qualities including their technical training. Moreover, much public help has been given. The Land Grant College system includes teaching, research and extension programs aimed to help young people (and older ones, too) obtain the knowledge needed in farming. Public education such as the vocational agriculture program in high schools has gone far to help young people develop the knowledge and skills required in farming.

Entry as Capitalist

The situation is more complicated and more difficult for entry into farming as supplier of capital including capital for land ownership.

As stated earlier, family farmers need not own all their land, but it is expected that they will acquire ownership of at least part of it. In other words, part ownership can qualify as family farming.

Even operating capital requirements have become sizable. Depending upon the size and kind of family farming unit, operating capital requirements in today's agriculture range from several thousand dollars up to several hundred thousand dollars.

Terms of access to finance capital have changed over time. The Homestead Act passed in 1862 made land available to those who would live on the land and improve it. Somewhat later, but when land was still abundant and inexpensive, it was assumed that a farmer could pay for his land by "climbing the ladder" – from hired man to tenant and finally to owner.

After land became more costly, the tradition continued of helping farmers to get funds, primarily by borrowing. In keeping with the family farm principle, the operating farmer was to own the farming assets. The farmer would get money by borrowing and not by selling shares of stock. The objective was to avoid transferring managerial control to outside investors who would buy stock.

In line with this principle the cooperative credit system was authorized. In 1916, Congress passed legislation that was the beginning of the present farm credit system. The cooperative farm credit banks and associations, although now owned by borrowers, were established by the U.S. government to help farmers obtain land and operating capital.

In the 1930s the first direct loans were made available to beginning farmers with limited resources through the Farm Security Administration which later became Farmers Home Administration. This program continues but with limited resources.

In spite of all the supportive legislation and associated programs since the 1930s, the trend toward fewer family farms continues. Entry into agriculture by the beginning farmer is probably as difficult, if not more so, than ever. Tax rules, inflation and availability of land are major forces that hamper entry into family farming by the young, low-equity farmer.

Tax Rules Now A Major Force

The family farmer "climbing the ladder" paid for land and equipment by diverting part of his labor income. He often did so at considerable sacrifice to his family. Tax rules now make it possible to divert money otherwise payable as income tax. This is, in fact, an indirect government subsidy, a sizable source of capital.

Some of the tax rules which affect the amount of capital going into agriculture include: cash accounting, capital gains and associated tax shelters, investment tax credit, graduated tax rates, estate taxes and federal taxes on farm corporations.

Federal income tax laws have granted preferred treatment not only to taxpayers who are operating farmers but to all persons having agricultural incomes. Cash accounting, for example, allows accelerating or delaying certain income and expense items. This, combined with tax rules permitting current deductions of development expense, allows deductions before the income is realized. For much development expense there may be the additional attraction of conversion to capital gains. While this may help the beginning farmer in some cases, it can help large farmers and outside investors more.

These tax rules create a strong incentive, especially with high inflation, for high tax bracket investors, whether farm or non-farm, to invest in agriculture. This, in turn, has contributed to the rising price of agricultural land.

Those individuals in high income tax brackets seeking tax shelter have a very decided advantage over the beginning farmer depending solely upon farm income. While the beginning farmer must have a favorable cash flow from the farm, the high income buyer does not. He can "feed" his investment if necessary and depend upon land appreciation to bring about an annual increase in net worth. If land is sold, capital gains tax rates apply.

Most of the land sales continue to be from one farmer to another, but someone in the 50 percent tax bracket, regardless of occupation, has considerably more incentive for tax shelter investment than someone in the lower tax brackets.

In addition, those individuals not solely dependent upon the farm business for repayment hold an advantage since lenders prefer lending to those with diversified incomes.

Investment tax credits are available to those who want to buy certain kinds of machinery, equipment, and facilities. It comes directly off the top of the taxes due, so this encourages the individual who has had a good year, and high income taxes, to make an investment in new or bigger equipment and facilities. In essence, this is pushing part of the cost of machinery and equipment to the public.

...a major barrier to entry is the current price of land...

This policy provides the individual with funds for capital which otherwise would have been used to pay income tax. The subsidy is no doubt more attractive to the established and wealthy farmers who can best utilize and afford the larger and newer machinery or who are in the best position to buy more land.

Other tax policies that either do or could impact on the availability of land are the federal tax laws on farm incorporation enacted in 1978 and the estate tax laws.

When farm income becomes high enough, a farmer may realize a substantial tax saving by incorporating and gaining access to subsidized capital through retained earnings in two ways: (1) tax rates are lower for the incorporated farm than for the high income individual farmer, and (2) corporate earnings can be retained by paying low dividends since dividends are subject to the so-called double tax. Through this process current income can be used to buy more capital items including land – and access to land ownership for beginning young farmers becomes even more difficult.

Under current estate tax laws the tax is usually not so burdensome as to cause the sale of ongoing family farms. The desire of the heirs to get their share of the estate is far more important in causing the farm to be sold than the estate tax.

...sale of small tracts off larger farms could help family farming...

Current estate tax laws are progressive and do bite harder on the larger estates. However, current law permits special use valuation and delayed payment so that little selling of land to pay taxes is likely. Actually, requiring some sale of small tracts off the larger farm holdings could help family farming, as those tracts are what young farmers want to buy to get started. An easily payable tax on the larger land holdings causes land to be transferred from generation to generation even though the heirs are not interested in farming.

Inflation and the Beginning Farmer

Inflation affects the young farmer trying to get established. Inflation tends to shift the interest of the individual from efficiency of production to financial management – sometimes called financial juggling.

A major barrier to entry for the young family farmer is the current price of land. Recently land prices have been bid up, not just because of earning from farming, but also because of expected inflation. Inflationary expectations are now a major force in our economy. Once inflationary expectations have developed as they have during the past decade, they may be expected to interact with and intensify other factors to accelerate inflation.

Land has been one of the best inflation hedges during the past few years, attracting farm and non-farm investors alike. Bidding up the price of land, based on further inflation expectations, creates cash flow problems for the young farmer in a low equity position.

Cash flow problems create the need for outside income to "carry" the farm and may result in part-time farming. In fact, one of the major factors that appears to enhance the probability of successful entry into farming is off-farm employment by the farmer or his (her) spouse. Off-farm employment reduces the need for the farm to provide family living expenses. Non-farm and farm income can be reinvested in the farming operation. Thus, cash flow problems are reduced.

Inflation combined with corporation tax provisions will affect the way farms are organized. As inflation continues and individuals are pushed into higher tax brackets there is financial incentive for a farmer to incorporate. Beginning in 1979, the first $25,000 of corporate income is taxed at a rate of 17 percent, the second $25,000 is taxed at 20 percent, the third $25,000 at 30 percent, and the rates get progressively higher up to a maximum of 46 percent.

While it is difficult to compare individual and corporate tax rates, it is clear that corporate tax rates are lower for the higher incomes. This situation suggests a continued push toward incorporation, away from the traditional farm organization, and more difficulty for farmers outside established families to get started.

Current inflation also provides incentive for holding land by non-farming heirs or others since land has been appreciating 10-20 percent annually for the past decade. Very little land is offered for sale in some of the better land areas. Consequently, young farmers find it difficult to buy land even at inflated prices.

Existing Programs to Assist Beginning Farmers

Some states, as well as the U.S. government, provide financial help to beginning farmers. Through the FmHA farm ownership program, qualified applicants who will manage and operate farms not larger than family size may be eligible for a loan up to $200,000 under the FmHA insured loan program and $300,000 under the guaranteed loan program. The repayment period may not exceed 40 years.

Generally the interest rate on insured loans is based on the cost of government borrowing with periodic adjustments as interest rates change. The main general qualifications applicants must have are: (1) farm experience or training to enable them to succeed in farming, (2) debt repayment ability, (3) managerial capacity, and ability to perform most of the labor involved and, (4) be unable to obtain sufficient credit from commercial lenders at reasonable rates and terms to meet their needs.

During the fiscal year 1977-78, FmHA made approximately 12,000 farm ownership loans totaling about $550 million. In 1979 this had increased to $750 million with about 12,500 borrowers. The total amount of loans made by FmHA is limited by appropriations.

The FmHA also has a program called limited resource loans to which they allocate about one-fourth of their farm-ownership loan funds. Applicants who have low incomes and cannot pay regular interest rates may be eligible to receive low interest loans initially with scheduled increases in later periods. In 1979 over 3,000 limited resource loans were made amounting to $237 million. Since requests for limited resource loans far exceed the money allocated a problem arises as to who qualifies for help. How are the truly talented and dedicated to be identified and selected?

...a problem arises as to who qualifies for help...

State programs to provide financial assistance to beginning farmers are not widespread. However, there have been some pioneering efforts.

Probably the most innovative and extensive program is one carried out by the Canadian province of Saskatchewan. Under this program the Saskatchewan Land Bank Commission acquires title to land which it in turn leases or sells to beginning farmers. The Land Bank Commission may also make loans to beginning farmers for various operating and improvement purposes. To be eligible under the program the applicant must have net income and total net worth below an amount established by regulation and declare an intent to make farming his/her principal occupation. He/she must be a resident of the Province and a Canadian citizen. After a period of five years as a lessee, he/she may make application to buy the land. The lease expires at age 65 or terminates upon the death of the lessee.

During 1977, the Saskatchewan Land Bank Commission offered to purchase 350 parcels of land from private vendors and acquired 168. These parcels totalled 118,000 acres and cost about $18 million.

About 1,200 applications were made to lease land from the Land Bank Commission in 1977. Of these, 385 resulted in long term agreements. The average age of lessee was 32 years. Funds used in financing the program are received from the Saskatchewan Department of Finance in the form of long term loans.

North Dakota and Minnesota have programs of comparatively limited scope. Under the Minnesota program, the state provides a loan guarantee for qualified beginning farmers who are unable to obtain credit through regular commercial channels. In the first 39 months that the Minnesota program has been in operation, the state has guaranteed 218 loans covering the purchase of 36,000 acres. The Minnesota program also encourages sales of Minnesota farm land to young beginning farmers by excluding the interest received by the seller from state income taxes.

Applicants must have farming as their principal occupation, be credit worthy, possess the ability to manage, have a net worth of less than $75,000 and demonstrate a need for the loan, as well as meet other requirements. Recommendations about eligibility of applicants are made by a seven member advisory council. Under the North Dakota program, the state takes a more active part in arranging financing for applicants than under the Minnesota program.

These programs, while not large, illustrate the kinds of measures that might be implemented by governments to assist young farmers in getting started. These programs, in essence add a new demand aspect to the land market. Therefore, if they should grow to a significant size, they could become a factor in determining land prices. Also proposals for government programs that might replace or compete with existing lending institutions tend to generate considerable political opposition.

...not everyone who wants to farm can be enabled to do so...

What are the public interest justifications for programs to assist beginning farmers? First, assisting beginning farmers could help to slow the trend toward greater concentration of farming resources into fewer and fewer hands. Second, assisting beginning farmers helps make meaningful a deeply held value in our society – equal access to opportunity. In farming, the application of this value is in danger of completely disappearing.

In summary, even with the most comprehensive and generous public assistance program, not everyone who wants to farm can be enabled to do so. However, if the trend away from family farming is to be reversed, two lines of action are probably necessary: (1) reduce or remove obstacles that place the beginning farmer at a disadvantage, and (2) provide larger public financial assistance programs.

How Do Public Policies Affect the Beginning Farmer?

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