AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

POLICIES TOWARD CORPORATIONS IN FARMING

Philip M. Raup, Professor
Department of Agricultural Economics
University of Minnesota

A first step in the discussion of policy toward corporations in farming is to recognize the existence of at least three types of farming corporations:

1. The closely held family (or sometimes one-man) corporation, engaged primarily in farming.
2. Closely held, often family-type, corporations combining a farming enterprise with some other business activity, which may be either (a) related to agriculture or (b) unconnected with farming.
3. Publicly traded corporations, typically involved in farm production and in an agricultural supply or processing activity, but in a few cases organized explicitly to engage primarily in farming.

Recent studies by the U.S. Department of Agriculture have identified a total of 11,500 corporations engaged in farming in 47 states (excluding California, Alaska, and Hawaii, for which data are as yet unpublished). The total for the 50 states is expected to reach 14,000, or about 1 percent of all commercial farms and ranches.

For the 47 states, 68 percent of all corporate farms and ranches were family corporations, sometimes involving farming with some other business activity. Some 12 percent were one-man corporations, and 20 percent had diversified ownership. Less than 100 corporations producing farm products had their capital stock listed and traded on organized stock exchanges. In total, corporate farms operated an estimated 7 percent of the land in farms and accounted for approximately 9 percent of the gross value of farm products sold in 1967.

These percentages are relatively small for U.S. agriculture as a whole, but they are large for specific products and in a few states. Corporations accounted for 31 percent of all land in commercial farms and ranches in Florida, 28 percent in Utah, 22 percent in Nevada, and from 11 to 17 percent in the remaining Mountain states, and in Massachusetts, Rhode Island, and Connecticut. Among products, corporation farms were especially prominent producers of poultry products, fruits, vegetables, and beef cattle.

Over half of all existing farming corporations have been established

since 1960. While the majority of these have been family-type farming corporations, the period since 1960 has also seen the appearance of two types of farming corporations that are new on the American scene: the relatively large corporation engaged explicitly in farmland clearing, drainage, and improvement (especially prominent in the Atlantic Coastal and Mississippi Delta states) and the large conglomerate corporation branching out into agriculture. Although few in number, it is this latter type of corporation in farming that gives rise to much of the current concern.

Much of the concern about farming corporations is at root a concern about bigness in farming. Many of the big farms in America are not incorporated. If attention is confined strictly to corporations in farming, an important aspect of the issue will be neglected.

CLIMATE OF OPINION

Public and professional opinion regarding food surpluses and famine threats has swung through a wide arc in recent years. Concern with agricultural surpluses in the late 1950's and early 1960's shifted to fears of an impending world-wide shortage of food in the mid-1960's. We are now well away from this peak in the belief in an impending food shortage, and surplus threats are again worrisome.

If nonfarm investors have channeled capital into agriculture because they expect world population growth to generate food shortages and higher prices, they are almost surely going to be disappointed. Yet it seems probable that a part of the interest of nonfarm investors in farming corporations during the mid-1960's grew out of a belief in farming as a "growth industry," based on a neo-Malthusian view of impending world food shortages.

This belief has been strongly reinforced by inflationary trends in the economy, and especially by rising land values. Farmland values have increased almost without interruption for thirty-five years. This is the longest period of sustained land value increase in our national history. Nationally, the index of farmland prices (1957-59 = 100) rose from 30 in 1940 to 111 in 1960, and to 176 in 1969.

The conclusion is inescapable that an anticipation of continuing land value increases is being built into expected returns from farming. The majority of the U.S. population has never known anything except rising land values. It is difficult to document the impact of this expectation on corporate decisions to engage in farming, but the impact has clearly been great.

This inflationary trend has unquestionably played a major role in determining the climate of expectations with which prospective investors

or incorporators have viewed the future of farming. In effect, it has meant that current annual returns could be quite modest or even zero, while leaving intact the promise of long-term capital gains.

INCENTIVES FOR FARM INCORPORATION

A Missouri study of family farm corporations in 1968 reported that 50 percent of the families incorporated to facilitate farm transfer and estate management, 30 percent for tax considerations, and 16 percent to limit liability. Improved access to credit was cited as a reason in only a few cases. These percentages are similar to those found in a Minnesota study in 1958 and confirmed in a repeat study in 1968. For family farm corporations, estate planning motives dominated. For closely held corporations combining farming with a nonfarm business activity, the primary goal of incorporation was usually to separate the assets of the principal stockholder's various enterprises, rather than to raise capital by persuading others to share as investors, although there were instances of the latter.

For nonfamily corporate farming firms, the motives for incorporation are more complex, including continuity of operation, limitation of liability, mobilization of capital, attraction of superior managerial talent, and tax advantages. For the large firm, the mobilization of capital may be virtually impossible without use of the corporate device to limit liability. It is important to note, however, that many large farming enterprises are not incorporated. In a current survey of some 50 large farms in the Midwest of over 2,000 acres in size, incorporated farms were a distinct minority.

This suggests that the focus should be shifted from the firm to the individual stockholder, in seeking a more adequate explanation for the recent interest in farming corporations by nonfarm investors. Given the importance of inflationary trends over the past decade, a history of rising land values over thirty-five years, and a tax policy that favors corporate types of investment for high tax-bracket individuals, it should not be surprising that there has been a recent expansion of interest in corporation farming.

Corporate investments in farm real estate have been stimulated in the past two decades by rapid advances in agricultural technology, an excellent press which has given wide publicity to the miracles of modern agriculture, and by the growing professionalization of management in agriculture. A part of the explanation for the growth of corporations in farming must be credited to the success with which our agricultural training institutions have combined training in traditional agricultural sciences with the more recently developed techniques of modern management. Farm managers of high quality are available for hire. But this is still only a part of the explanation.

DIFFERENTIAL ADVANTAGES OF LARGE OR CORPORATE FARMS

A landowner with a nonfarm income, or an investor in a farming corporation, will usually find it rewarding to convert as much of his farm income as possible into asset values, which can ultimately be taxed at the capital gains tax rate. Since this rate never exceeds 25 percent of the gains, this opportunity is especially attractive to individuals in high income tax brackets.

The nature of the farm business makes it especially attractive for the wealthy investor. Assets eligible for capital gains tax treatment are a large portion of total assets, and the bulk of his investment is represented by the most durable asset of all—land. The classic illustration is the beef cattle ranch. With most of the investment in land and a breeding herd, opportunities are maximized for appreciation in capital value, and subsequent taxation at not more than 25 percent of the gain. Similar attractions characterize orchards, groves, and vineyards.

When there are a few big farms and many family-type farms, a market for used farm equipment develops. This expands the options available to large or corporate farms in taking full advantage of rapid depreciation of machinery and equipment or in turning it over every two years, or less. Because of their size and capital position, large farms can make greater use of this advantage than can smaller farms. Incorporation is not necessary to enjoy this advantage, but it is an advantage that the large corporate farm can utilize.

Expenditures on soil and water conservation and related improvements on land can be deducted as current expenses even though expenditures of this type would usually be depreciated or added to the cost of the land in determining its base value. Expenditures on soil and water conservation can be deducted up to 25 percent of *gross income* in any one year, and carried forward to succeeding years until exhausted, subject to the 25 percent limitation each year. In effect, the whole of soil and water conservation expenses can be deducted from gross farm income over time. Deductions for expenditures on land clearing or improvement are limited to $5,000 in any one year or 25 per cent of the *taxable income* derived from farming in that year, whichever is smaller. There is no carry-over provision. Any part of land clearing expenses exceeding $5,000 or 25 percent of taxable income in any one year must be capitalized and added to the base value of the land. The benefits from the deduction of land clearing expenses are of principal value to those who have *taxable income* from farming of $20,000 or more in any one year. This deduction is of little value to a small farmer with a low taxable income.

One of the most important forces that has stimulated the growth of large and corporate farms is the way in which our graduated, progressive

income tax has been devised and administered. Permission to use a cash basis instead of an accrual basis for accounting is convenient for the small or medium-size farm, but of very little value in terms of reduced taxes. It is of monetary value to the large farm, ranch, or orchard, and especially to the very large nonoperating owner. Allowable deductions for expenditures on soil and water conservation or land improvement are primarily useful to farmers with large incomes. The taxation of capital gains at not more than 25 percent is of significant value only for those with very large incomes. A bonus for bigness has been unintentionally built into our tax system.

POSSIBLE CONSEQUENCES

Current concern about the accelerating trend toward corporation farming is due in large part to the fact that some of the farms are larger than necessary to achieve desirable levels of efficiency in resource use in farming. With the exception of poultry enterprises, beef-cattle feeding, and some types of orchard and vegetable crop production, research studies have shown that virtually all two-man farms are large enough to achieve most of the production economies to be gained from size of firm. With the exceptions noted, the economic argument for larger farms is not an argument for larger-than-family-size farms. Why, then, is there concern about corporation farms? Primarily, for three reasons:

1. A fear that many of the incentives leading to large corporate farms are not connected with greater efficiency or superior management, but are the result of institutional defects, particularly in the tax system, in market structures, and in agricultural extension programs.
2. A fear that the trend toward corporation farming is reinforcing a trend toward the centralization of economic power and decision making in a few hands and places, with a resultant loss of flexibility and diversity in our national economic life.
3. A fear that a rural social structure dominated by a small number of "company farms" will produce a deadening conformity and a restricted environment in which to develop the full potential of the quality of rural life.

There are grounds for these fears. We have already noted examples of distorted incentives generated by the tax system. Institutional defects that favor large or corporate farms are also apparent in the agricultural marketing structure, both for inputs and products. Farmers themselves are to blame for some of this weakness. They have often resisted the market discipline needed to make them competitive with large farms in product quality, uniformity, and stability of supply. Small producers can

compete with large firms in fields where product quality is critical. To do so, the small producer must surrender some of his sovereignty in farm management and marketing decisions to his suppliers, or to marketing or processing agencies. These may be cooperatives, or private businesses operating under contractual arrangements with the farmer. But in any case they must have power to impose production and marketing standards on their farmer members or contracting partners.

A related institutional defect concerns the increasingly complex nature of agricultural technology and the need for a greatly expanded agricultural extension effort if this complex technology is to be made effectively available to all farmers.

Much of the effort at user education for fertilizers, feed additives, farm chemicals, and animal medicines is supported by private industry. It is understandable that suppliers prefer to concentrate their sales effort on large-volume users. The costs of user-education programs or after-sales service rise sharply if many small users are involved. Agro-chemical technology can be divided physically into small doses, but the technical and managerial skills needed to use these small doses effectively are often beyond the reach of the average farmer. If the advantage in using this technology seems to lie with the large farm, it may be a measure of our inadequacy in agricultural extension rather than an example of true economies of large-scale production.

Smaller farms have in many cases been written off as production units by agricultural specialists and technicians. Their operators are classed as a welfare problem, not an agricultural potential. There are many instances of productive interaction between agricultural scientists, experiment station staffs, extension workers, and the operators of the larger commercial farms. It is more difficult to find instances of concerted efforts to perfect agricultural technology in "small packages," suited for use on the nation's smaller farms.

The second fear generated by the rise of corporation farming concerns the consequences for the national economy of concentration in agricultural production. Our existing structure of agriculture has facilitated the transfer to consumers of the benefits of cost-reducing technology in agriculture. It seems unlikely that the benefits to consumers of agricultural modernization will be as direct or as significant if the structure of agriculture is characterized by a small number of large producing firms. We know that large firms in agriculture must commit capital in large quantities to slow-maturing production processes. Unless the firm is large enough to control markets and practice a form of internal self-insurance against weather, these large capital investments will be high-risk. The understandable desire for risk reduction may lead to a degree of rigidity that

can retard technological progress, viewed in the long run. At the moment, the rapid adoption of new technology is thought to be a characteristic of the large firm. This may not be true if only large firms dominate the production field.

In the past, at the farm level, agricultural products have largely remained undifferentiated. There have been almost no "brand names" that carried back to the producing farms. With large corporations in the farming business, this is almost sure to change. We can already see the development of large-scale expenditures on advertising campaigns designed to create the illusion of differentiated products produced by large farms. If the trend toward bigness in agriculture is accompanied by increasingly heavy expenditures on nonfunctional advertising, it will be the consumer who pays. In this sense, it is not only farmers but also consumers who have a direct interest in the trend toward corporation farming.

For many people, the least tangible but most worrisome aspect of a trend toward corporation farming lies in the field of social policy. Absentee ownership has traditionally been associated with lack of attention to the amenities of life in rural areas and with an inadequate rural social infrastructure. It is not clear that a rural structure dominated by corporation farms must inevitably lead to a deterioration in the social quality of the rural environment. If corporate ownership is absentee, if profits are not reinvested in the community, if management success is judged solely in terms of corporate profits, then the corporation farm may pose a social threat to the rural community. This is not necessarily a condemnation of all types of corporation farming. If the corporation is predominantly a family affair, and its officers and stockholders reside in the community, there is no clear reason why this form of farm busines organization should pose a social threat to rural life.

The least desirable situation may be one in which farm corporations are larger than family-size and are absentee-owned, but not national in scope or scale of operation. This could lead to a type of "petty corporatism," comparable with the petty landlordism that has been the curse of slum areas in urban centers. It is quite possible to have farming corporations that are too small, as well as to have individually owned farms that are too small.

A POLICY POSTURE TOWARD CORPORATIONS IN FARMING

Much of the recent debate over corporation farms has centered on proposals to outlaw them. Outright statutory prohibition has been proposed and now exists in a few states. Alternatively, attempts have been made to distinguish between "good" or family-type corporate farms, and "bad" types, in which the stock is owned predominantly by nonfarm

individuals. These attempts at statutory prohibition or classification may not achieve the goals that are uppermost in the minds of those who urge this solution.

The alternative approach that seems most defensible is to insure that corporations in farming are not given intended or unintended advantages in the competition among sizes and types of farms that is now acute in American agriculture. Occasionally by design but largely by accident, our institutional structure now offers advantages for large and corporate farms. If competition among firms is to result in an economically and socially desirable structure of agriculture, the rules of the game must be fair. Insuring fairness in this sense is a highly subjective undertaking, but it is the overriding goal of public policy. The steps that can be taken in pursuit of this goal include:

1. A reform in tax laws and practices to remove existing and largely unintended advantages for the large or corporate farm.
2. Modernization and revitalization of agricultural cooperatives to provide much more managerial assistance to farmer members.
3. The strengthening of research and extension programs to focus more sharply on insuring the availability of agricultural technology and management services to medium-sized farms capable of achieving gross sales of $20,000 to $100,000 annually.
4. The expansion of environmental protection, waste disposal, and pollution control programs to include the whole of agriculture.
5. The active extension of labor and welfare legislation to cover the entire farm labor force.

From both economic and social points of view, the last two points are the most important. We have ample evidence that waste disposal and pollution control costs are high for large-scale, concentrated agricultural firms. A high priority in public policy should be given to the extension to agriculture of the full range of pollution control and environmental protective measures. If family-type farmers oppose this extension, they will make a major contribution to their own destruction.

This argument applies with even greater force to labor and welfare legislation. Over time, the extension of labor legislation to cover agriculture is virtually inevitable. We will experience one of the most inexcusable sequences of events in American agriculture if we shift to large-scale or corporate units of production, generated in part by the incomplete coverage of farm labor under collective bargaining laws, only to find that the resulting large units are peculiarly vulnerable to labor problems and high and rigid wage structures. To insure constructive competition among large farms, corporate farms, and family-type farms, it is essential that all of

the probable economic and social costs of alternative types of farms be taken into account. One of the biggest unknowns concerns the probable pattern of future wage costs and labor relations. The time to subject this to test is now, while the structure of American agriculture is still relatively flexible. To refuse to extend labor protective legislation to agriculture is one of the most irrational agricultural economic policy decisions possible. The refusal does nobody good, and the family-type farmer seems likely to suffer the worst injury.

To accomplish these needed policy changes, a change of attitude is needed. It will be ironic if American agriculture evolves a corporate-industrial structure exactly out of phase, at a time when that structure is under increasing attack in the nonagricultural world. The key issue is the devolution and decentralization of power—economic, social, and political. We have a relatively decentralized power structure in American agriculture. The majority of the men and women in the farm labor force can still legitimately feel they participate in decisions and processes that shape their lives. This sense of participation is being eroded away, but it still has vitality. The corporate form of organization can accelerate this erosion, or it can regenerate a sense of effective and rewarding participation in productive processes and in community life.

As a legal device, the corporation should be essentially passive in the process of change now under way in agriculture. Whether this change will be beneficial or harmful depends on what we do to alter the other dimensions of our institutional structure. How we change our tax laws, whether we revitalize our cooperatives, what we do with our resources of agricultural research and extension, the imagination with which we innovate in the field of agricultural credit, and how quickly we extend environmental protection and labor legislation to cover all of agriculture—these will be the determinants of policy toward corporations in farming.

The most discouraging aspect of much of the response to the expansion of corporate farming, large farms, and vertical integration is the manifestation of "technological determinism" that underlies the argument. Technology is accorded the status of an elemental force—an "act of God," in the ancient terminology of the courts. It is not analyzed as a product of man or as capable of alteration by his institutions.

We need to recall that not all growth is good, and not all change is progress. And we need, above all, to recall that the goal of our endeavor is not the production of goods, but the development of human beings. The ultimate test of a structure of agriculture, or of any sector in our society, is the quality of the people it produces. This is the goal that can give a durable and defensible order to our priorities in shaping policy toward corporations in farming.

PART IV

Foreign Trade and Development