Letters

Economic Analysis Matters

■ In their respective articles on the 1996 farm bill, Browne, Allen, and Schweikhardt (BAS, "Never Say Never Again," *Choices*, Fourth Quarter 1997) and Orden, Paarlberg, and Roe (OPR, "Can Farm Policy be Reformed?" *Choices*, First Quarter 1996) make similar points: the 1996 farm bill resulted from unique circumstances of the 104th Congress rather than from pressures for market-oriented policy reform. According to OPR (p. 5), the bill "...resulted more from accounting quirks and suddenly favorable market conditions than from either budget pressure or the dominance of a new policy reform consensus." According to BAS (p. 4), "No one has written into any bill a mandatory route to the free market that will be binding on future congressional decisions." Later (p. 9) they add that "the circumstances of the moment will prevail in the short-term world of Congress... Despite much congratulatory rhetoric heralding the end of farm programs, there is reason to believe that reports of the death of U.S. farm programs are premature."

Attributing the 1996 farm bill to chance events in Congress is equivalent to attributing World War I to the assassination of Archduke Ferdinand in Sarejevo. In their admirably thorough accounting of the tactics behind the 1996 farm bill, OPR and BAS overlooked strategic changes in the intellectual paradigm underlying agricultural policy. We contend that something very fundamental has changed farm policy for the long run. That is a reason why farm programs were one of the few social programs changed significantly by the so-called Republican revolution. It also helps to explain why there has been no retreating on the reforms.

Income transfers are difficult to sustain by raw political power in the absence of an intellectual paradigm appealing to a broad range of Americans. Commercial farmers who comprise about 0.5 percent of U.S. voters but receive the lion's share of policy transfers are no longer (if they ever were) in a position to dictate farm policy. The public must be acquiescent, if not enthusiastic, for a policy to pass sustained political muster.

We contend that the root cause of the recent (since 1985) movement toward less government intervention in commodity markets is a shift in the policy paradigm for agriculture. We contrast the old and new public policy paradigm for agriculture in "Public Policy for Agriculture after Commodity Programs" (*Review of Agricultural Economics*, vol. 19, no. 2, pp. 263–80). Refer to the article for details, but note here that the new paradigm recognizes that commercial agriculture is now near long-term economic equilibrium (it never fully reaches it) with rates of return on resources comparable to what those resources could earn elsewhere. This contrasts with the old paradigm emphasizing economic disequilibrium in the form of excess production capacity, excess labor, and chronic low rates of return on resources.

We describe but did not invent the new paradigm. The new economic paradigm has been widely held by economists including those working with congressional committees and the executive branch, e.g., the U.S. Department of Agriculture and the Council of Economic Advisors. It would be very difficult for any member of Congress not to be informed of the new paradigm given their wide exposure to analysts. What Congress sought was a politically palatable opportunity to incorporate that new paradigm in legislation.

If BAS and ORP are correct, a return to low farm prices would be expected to bring back market-distorting farm policies. Such a return is unlikely because the farm policy paradigm has changed. The new paradigm recognizes that the role of government is to correct externalities and supply public goods. Hence, public programs for the environment, basic research, and information systems will continue. The new paradigm recognizes that farm commodities are transparent, rival, and exclusionary goods most efficiently left to markets, and that farming is no longer a welfare case justifying continuing subsidies from taxpayers or consumers. Washington knows that. Thus, we do not expect a return to coupled payments, acreage set-asides, sizable buffer stocks, or target prices.

Because tobacco, sugar, and peanut producers have become highly dependent on commodity programs, and their subsidies are not obvious because they are paid through higher consumer prices, these programs will be more slowly phased down. Transition payments are likely to become "green" payments after 2002. As such, they may be scaled back and increasingly will address environmental problems rather than be pure transfers. Thus, we predict that transfers will continue to decline as a percentage of farm income. This outcome is consistent with the new paradigm, with welfare economics, and the notion that economic analysis plays an important role in public policy for agriculture.

The issue of risk in the new paradigm deserves attention. To be sure, agriculture faces considerable risk, but private risk management tools are abundant (and more would be developed if government risk insurance were ended) and farmers can afford to use available tools. Public subsidies to risk insurance drive out private risk management tools, subsidize farming of fragile lands in high-risk areas, and encourage unstable farm production. Whereas careful analysis might justify a public role in risk management because the discount rate is lower for the public than for private risk managers, the poor record of governments in risk management by insurance, buffer stocks, or price supports provides little justification for public intervention. We predict that modest emergency grain reserves, crop insurance, and market loans will be continued after year 2002 when the current bill expires. Such modest efforts are consistent with the continued phasedown of commodity programs and the government being a soft touch for risk. To illustrate the latter, we note that U.S. disaster assistance is routinely granted for anything remotely resembling a disaster.

Other lessons can be learned from the agricultural policy reform since 1985. One is that economic analysis matters. It is easy to underestimate the still powerful Enlightenment philosophy of our founding fathers that rational thinking and sound information is a surer guide to a better society than is following emotions, special interests, and raw political power. Our founding fathers designed Congress to slow the pace of change, thus increasing the chances that potential policies are carefully scrutinized and debated before enactment. In this tedious process, it is easy to lose sight of slowly evolving, but revolutionary change.

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Limited Liability Company
Tax Tips

■ In her article "Limited Liability Companies: A New Tool for Small Agribusiness?" Lisa Offenbach House makes reference to the potential tax liability when an existing corporation is converted to an LLC. Most articles fail to mention this tax trap. However, there is a way around it. Many states allow merger of a corporation with an LLC without adverse tax consequences.

Limited Liability Companies (LLC) offer many planning advantages, and when combined with an Employee Stock Ownership Plan (ESOP), the agribusiness owner has several unique planning opportunities.

The ideal situation is where the agribusiness establishes an ESOP that owns 99 percent of the LLC and the individual one percent. Consider the possibilities. After the owner's salary and expenses, all remaining profits are divided according to the operating agreement, which means one percent could be taxed to the owner and the remaining ninety-nine percent to the ESOP. The advantage is that the ESOP is not required to pay tax on its earnings. Therefore, 99% of the profit goes to a qualified plan on a pre-tax basis.

One of the unique features of an ESOP is that it is authorized to invest in its parent company, which means those same pre-tax dollars can be injected back into the LLC. The practical result is that the LLC can reduce debt on purchase land, equipment, or other improvements with pre-tax dollars. Depreciable assets are still depreciated, which, when using pre-tax dollars to purchase the asset, is tantamount to tax-deducting the cost twice.

Like many of our tax laws, the individual must take the initiative and implement the planning. The LLC and ESOP are no exception.

It is interesting to note that the Senate Finance Committee described an ESOP as follows:

> An ESOP is a qualified stock bonus plan which is designed to invest primarily in employer securities for the benefit of employees and which may be utilized as a technique of finance.
>
> ...the congress...has reflected its interest in encouraging ESOPs as a bold and innovative tool of corporate finance for purposes of strengthening the private free enterprise system.
>
> ...the Committee believes it appropriate to restate the purpose of ESOPs as a technique of corporate finance... thereby distinguishing it from other employer benefit plans... (Senate Finance Committee Report to H.R. 3838).

Combining an ESOP with an LLC allows the owner to utilize the ESOP as an innovative tool of corporate finance. There are many additional benefits of the LLC - ESOP. It is a powerful planning tool when properly applied.

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Profiles of Profession's Leaders Important

■ The Fourth Quarter 1997 *Choices* contained an excellent article on Siegfried Von Ciriacy-Wantrup and his career. Earlier articles reviewed the careers and ways other "giants" advanced our profession. These articles fulfill an important, indeed critical, need in the profession: They inform readers about who originated the major advances and why these advances continue to be important. They also inform readers about the fundamental ideas, concepts, and theories that undergird food, farm, and resource economics.

Choices provides more and more high-quality, well-written articles. This fact makes clear that demand for space is highly competitive—the dream of every editor. I urge that *Choices* continue allocating space to the "giants," and also that *Choices* soon seriously discuss the benefit to the profession of publishing such articles in a future book.

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