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Staff Paper Series

STAFF PAPER P72-15

MAY 1972

NEEDED RESEARCH INTO THE EFFECTS OF LARGE SCALE FARM AND BUSINESS FIRMS ON RURAL AMERICA

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Staff Paper P72-15

May 1972

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Department of Agricultural and Applied Economics

Needed Research Into the Effects
of Large Scale Farm and Business Firms
on Rural America

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University of Minnesota, St. Paul
Before Subcommittee
on Monopoly
Senate Small Business
Committee
Washington, D.C.
March 1, 1972

Large firms and the centralization of economic power have long been a source of concern in the American economy, but only recently has this been the case in agriculture. Apart from some flurries of excitement in the land-boom and bonanza-farm days of early settlement, there were no real threats from monopoly power in agriculture until after the second World War. The Trust-Busting era largely by-passed American agriculture.

For the past half-century, structural policies for agriculture have been dominated by technical considerations. The major advice to farmers has been to expand the size of their farms. The criterion of success has been the achievement of lowest unit cost in a micro-economic sense. In measuring this achievement, many economic and social costs that are external to the farm firm have been left out of account.

With the development of truly large-scale firms in agriculture and related businesses, it is increasingly clear that questions of farm size and structure must be answered in terms of their effect on the entire economic and social system, and particularly on the rural community. Calculations of costs and returns within the framework of the agri-business sector will not provide an adequate basis for comparison of the merits or deficiencies of firms of different size or organization.

This statement attempts to set forth some of the key questions raised by the appearance of firms large enough to pose a threat of monopoly power in rural America. Answers to these questions will require

data that are often deficient, or lacking. Suggestions will be made as to research that is needed to provide these data, and to equip private citizens and their political leaders with the information needed for wise policy formulation.

An economic rationale for the large firm in agriculture lies in the fact that it can internalize benefits from large scale that fall outside the control of small firms. The use of large-scale equipment is the example most frequently cited. Other examples include bulk purchasing of supplies and equipment at discounts. These result from the fact that the large firm has greater bargaining power and can bypass conventional units in the retail distribution chain. Incorporation, better accounting, and superior business management practices can improve access to capital markets. Large-volume production permits exercise of market power in the sale of products. The ability of large firms to internalize these scale benefits is the principal reason why farm management advice throughout the past 50 years has focused on increasing farm size as a solution to problems of low rates of profit and inadequate family income.

Only in the past decade has serious attention been given to the fact that the large agricultural firm is also able to achieve benefits by externalizing certain costs. The disadvantages of large scale operation fall largely outside the decision-making framework of the large farm firm. Problems of waste disposal, pollution control, added burdens on public services, deterioration of rural social structures, impairment of the tax base, and the political consequences of a concentration of economic power have typically not been considered as costs of large scale, by the firm. They are unquestionably costs to the larger community.

In theory, large-scale operation should enable the firm to bring a wide range of both benefits and costs within its internal decision-making framework. In practice, the economic and political power that accompanies large size provides a constant temptation to the large firm to take the benefits and pass on the costs.

The rural community receives the immediate impact of this ability of large farm firms to practice selective internalization of benefits and externalization of costs. One of the most pervasive consequences is that the occupational composition of the population changes. Instead of a large number of small entrepreneurs, combining the functions of manager and laborer, the occupational structure includes a small number of managers

and a large number of workers. In rural communities dominated by very large firms, the settlement and housing patterns reflect this increasingly transient nature of the labor force. The symbol of the large corporate farm becomes the trailer house. Community institutions suffer from lack of leadership, and from the lack of a sense of commitment on the part of the labor force to long-run community welfare. Those institutions that survive take on a dependent character, reflecting the paternalistic role of the dominant firms. Income levels may stabilize, but at the expense of a decline in local capacity for risk-taking, decision-making, and investment of family labor in farms and local businesses.

In many cases the rural community declines. Per capita costs of public services go up or the quality of service deteriorates, or both, and the youth of the community are forced to go elsewhere if they are to obtain adequate training, and employment. Poor schools, poor roads, deficient housing and limited cultural opportunities tend to be associated with rural communities dominated by large firms. Examples can be found in California, Colorado, Florida, Texas, the Mississippi Delta States, and elsewhere.

A size of community that can support service staffs for farm supplies and equipment has long been recognized as important to a healthy rural structure. But staffs needed to service the household have expanded greatly in recent years. A shortage in these skills may be more critical than a shortage in fertilizer or feed supply, or in farm equipment repair and maintenance capacities, in determining the future viability of rural communities. Electricians, plumbers, TV repair shops, service centers for kitchen equipment-these are among the key service functions of communities that aspire to a service-center role in the future.

It is noteworthy that a deficiency in the supply of skilled tradesmen of this type is often one of the most pronounced features of "company towns" or communities dominated by a few large firms. This difference is clearly evident in Arvin and Dinuba, the two California communities studied by Walter Goldschmidt in the mid-1940's. Arvin, the large-farm community, is short of skilled tradesmen of all kinds.

In the early 1960's, farm laborers and foremen were 36 per cent of the labor force in Arvin, 13 per cent in Dinuba. Professional and related skilled trade and service staffs were 6 per cent of the labor force

in Arvin, 15 per cent in Dinuba. In Arvin in 1960, 19 per cent of the population over 25 years had completed high school. In Dinuba, the small-farm community, the figure was 38 per cent.^{1/}

These considerations suggest that a major area in need of further research involves the effect of large-scale firms on the education, composition, training, and balance of the labor force in rural communities. The quality of the people is the ultimate test of a community. This should be the central focus of any study that attempts to assess the impact of large scale firms in rural areas.

The effect of firm size on the environment is closely related to effects on people. What has appeared to be an example of economies of scale in agri-business production often turns out on close examination to be an example of successful transfer of pollution control or waste disposal costs and consequences to the neighboring community. Examples include packing plant and feedlot wastes in livestock feeding areas, water pollution through heavy use of agricultural chemicals in irrigated areas, watershed and water table deterioration where large-scale drainage has been attempted, and the disturbance of ecological balance associated with heavy use of insecticide and related agricultural chemicals.

By law, the National Environmental Policy Act now requires that a study of the environmental impact of any major federal investment or development project shall accompany the project proposal. Admirable as it is, this requirement fails to cover the many private developmental decisions that together may have a greater effect on the environment than do public investments. This applies with particular force to the development of large scale agricultural firms. In an urban and industrial setting, the agencies of government are sometimes strong enough to enforce pollution control and waste disposal policies on large private firms. This is rarely the case in rural areas. Government is weak, all too often dominated

^{1/}Bruce L. LaRose, "Arvin and Dinuba Revisited: A New Look at Community Structure and the Effects of Scale of Farm Operations", unpublished manuscript, Department of Agricultural and Applied Economics, University of Minnesota, March, 1970, and U. S. Census of Population, Characteristics of the Population, Part II, California, 1960.

by the large firms, and unable to devise, enact, or enforce environmental protection measures.

A substantial body of professional literature is now developing with regard to agriculture's responsibility for environmental problems. With few exceptions, this literature does not identify the differential impairment of the environment by size of firms. If the major polluters are large scale firms, the technical studies rarely say so.

What is now needed is a research effort that will alert communities to the potential environmental costs of large scale agri-business firms. It is clear that not all of the environmental deterioration traceable to agriculture is caused by large firms. But it is also clear that much of it is. Rural communities are beginning to be aware of the need for zoning to protect against residential misuses of land. It is ironic that some rural communities now regulate residential lot size and household septic tank installations but remain unable to control the pollution caused by large agricultural firms.

The ultimate ability of large-scale firms to externalize costs is measured by their capacity to pass on cost-of-production increases to consumers. It is this possibility that poses the most serious long-run threat from large-scale firms in agribusiness. As long as there are alternative sources of supply from a large number of relatively small-scale farms, the pressure of competition compels large firms to pass on cost reductions to the consumer. Many would argue that the consumer has been the principal beneficiary of the remarkable increases in agricultural production efficiency over the past half-century. The family type farmer has been notoriously unable to retain many of these benefits and his relative income position shows it.

In this structure of large and small farms, the large farm appears to be efficient, cost-conscious, and the source of much of our efficiency in agricultural production. But this could well be a transitional phase. If there are only large farms, the potentials for collusion, market sharing, restrictions on entry of new firms, and outright supply control are enormously increased.

It is a part of our mythology of large firms that they are efficient. But the key question is: efficient at what? For very large farms, the answer is clear: At the exercise of market power. We have never witnessed the exercise of market power by truly dominant firms in agriculture.

We have only industrial analogies to guide us. If the large firm has its power base in the ownership or control of land, there are legitimate reasons to fear that industrial analogies may be misleading.

There are few large-scale business firms, apart from mining and forest products, that can look to land value appreciation for any substantial part of their long-run prospects for firm growth. The situation in agriculture will be quite different. There is well documented evidence that much of the non-farm capital that has entered agriculture in the past two decades has done so in anticipation of capital gains in land. A desire for food is not the only source of the demand for land that has increased its price. Rural land is increasingly demanded by a variety of non-farm users, for residential, recreational, watershed protection, and many other uses.

The effects of local monopolies of rural lands in the hands of a few large agribusiness firms will not be confined to the consumer's food budget. It is in his role as user of rural land for non-food purposes that the consumer may feel the impact of rural land ownership concentration most keenly. Food can be imported. The consumer can go abroad in search of cheaper recreation or residential amenities, but he cannot import the sites. The effects of concentration in agriculture are quite likely to drive up the relative price of food, in the long run. They are certain to drive up the costs of non-food producing uses of rural land. It is this consequence of a trend toward large scale firms in agriculture that should be of greatest concern in an affluent society.

The research that is called for is an inventory of who owns rural America, and not simply its agricultural land. Recent history is replete with examples of a belated realization by states once considered rural--Colorado and Montana are prominent examples--that their most valuable recreational resources have passed silently and swiftly into a few hands. The need to alert rural communities to the problems of land monopoly sounds like an echo from a 19th century cry. It is all too real and current.

Rural communities, especially in Appalachia, New England, the Ozarks, and the Mountain States, need help in the development of land policies. The local political structure frequently makes it peculiarly difficult to persuade them that the regulation of land transfers is in their

interest. And in the states most affected, support for the research that is needed is often weak even at the state level. A relatively few local communities currently have control, such as it is, over the nation's recreational lands. A national effort is needed to help them to accept and discharge this responsibility.

A part of the reason why big firms are attracted to agriculture can be traced to the heavy capital requirements of modern agricultural technology. Special buildings for poultry, complex feed formulas that require expert mixing, special seeds, highly tailored fertilizers, high-capacity field equipment, \$12,000 trucks, \$20,000 tractors, and \$30,000 combines all put a heavy strain on the ability of a farm family to finance a large and well organized farm. Much of the vertical integration that has occurred in American agriculture is a result of the supply of credit to farmers by firms supplying production requirements or processing farm products.

But this is only a part of the explanation. In many types of farming there are added attractions to big firms that grow out of our tax structure and our system of government price supports for agriculture. The price support program reflects conscious policy. The tax advantages for big firms are an accident, and were almost certainly unintended.

Because we have a graduated and progressive income tax, and because we tax capital gains at a low rate which becomes a flat rate for incomes above about \$52,000 (married couple, filing a joint return), we have built in a strong incentive to convert ordinary income into capital gains. This option is of little or no value to the year-to-year operation of a family sized farm. It is of great value to a high-income taxpayer who can use non-farm income to invest in farm capital which can benefit from capital gains tax treatment. The most common examples involve beef breeding herds, tree and vine crops, large dairy enterprises, and horses.

Big firms have been created to channel capital into these enterprises in order to take advantage of capital gains tax treatment. Movie stars and oil millionaires have become ranchers. Citrus, tree-nut, and vinyard properties have inflated in value as a result of competitive bidding from wealthy investors. The economies of California, Texas, Florida, and the Mountain States, to cite only the best publicized examples, have been

distorted by an inflow of capital that is basically seeking a tax shelter.

This tax shelter function of agriculture is inextricably related to its land base. A careful review of prospectuses issued by firms seeking investors in ranching or beef feeding and slaughter enterprises makes it clear that the major attraction is prospective land value appreciation. The firms that have gone spectacularly bankrupt in recent years, headed by the Black Watch Angus enterprise, have been those in which the investors had only cattle from which to reap capital gains. Someone else held the land. The tax shelters that function best are ones in which the investors have secured their investment with a stake in the land as well as in the animals, orchards, or groves. The lesson is clear: If you want a safe tax shelter in agriculture, make sure your investment includes rights in real estate.

An operational rule of thumb in cattle ranching at present prices is that a ranch buyer can afford to pay from \$600 to \$800 per cow-calf unit for ranch land. That is, he can afford to pay up to about \$800 for as many acres as it takes to provide a year's feed supply for a cow and calf. A price of \$800 can be justified only by a highly efficient ranch operation, and an optimistic long run appraisal of beef cattle prices. In mountain ranching areas of Colorado, Wyoming, and Montana today ranch land is selling at twice the prices any operating rancher can afford to pay. In 1970-71, prices up to \$1500 per cow-calf unit, or more, were being paid without hesitation.

How can buyers afford these prices? There are two answers, apart from the romance of ranching. Some of the ranch buyers expect to sell off or lease a part of the ranch land for summer residences or "second homes." They are thus buying into a dual enterprise: a ranch and a real estate development. But the major explanation is that they are using the tax advantages that come from the use of cash-basis accounting (which the Internal Revenue Service permits in farming but not in other businesses) and capital gains tax rates to bid up the price of land. The richer the investor, the greater this tax advantage. The result has been described as a negative income tax for the rich.^{2/}

^{2/} Charles Davenport, "A Bountiful Tax Harvest", Texas Law Review, December 1969, p. 9.

These tax advantages are dramatic in ranching, tree-nut groves, vineyards, and specialized livestock breeding enterprises. They are less attractive but still real in ordinary farm land. Some of the fun was taken out of the tax shelter game by the federal Tax Reform Act of 1969. For long-term capital gains in excess of \$50,000 the tax rates for individuals were raised from a maximum of 25 per cent to 35 per cent, effective with the tax year 1972. For corporations, the capital gains tax rate was raised to 30 per cent, effective in 1971. These still remain highly attractive rates to investors in the top income tax brackets. They can afford to bid this advantage into the price they offer for land.

This is part of the explanation for the rural taxpayer revolts against the property tax that have erupted in recent years. Land prices have been bid up by non-farm buyers to levels that have no relation to farm earnings for ordinary family farmers. The higher prices have generated unrealistically high taxes. The demand for second home sites, outdoor recreation opportunities, and decentralization of urban areas has come on top of these tax advantages for upper income investors. The result is a structure of rural land values that is increasingly unreal by any test based on net farm income. Farmers who have succeeded in increasing their farm size to a scale that will enable them to achieve almost all of the economies of size in production now find that their capital structure is so large that their sons cannot finance a takeover of the family farm.

Research needed in this area involve a search for ways to reduce land values to levels that can be supported by farm income. One way is to reduce the attractiveness of land to non-farm investors. Tax policy can play a major role in this attempt. In recreational areas and in areas that feel the impact of urbanization, it is difficult to avoid the conclusion that some controls will ultimately be needed on land transfers. Zoning has been tried, and in general has failed to preserve agricultural lands for agriculture. We accept restrictive zoning and building permits in urban areas as a necessary restriction on individual freedom of choice. We do not yet accept exclusive agricultural zoning backed up with farming permits as tolerable, but this may well be the price that must be paid to maintain a structure of competitive farm firms. Without some controls of this nature, the trend, in recent years points to a

clear alternative: A structure of rural land ownership dominated by large firms and corporate holdings.

Apart from specialized firms in poultry, cattle feeding, and some fruit and vegetable crops, there is almost no evidence that very large firms are more efficient when all costs are taken into account.^{3/} If they prevail, it will be the result of defective institutional structures, above all the tax system, of farm programs that favor large farms, and of an insistence on freedom of choice in land transfers that is both blind and self-defeating. Rural communities have watched land values go up and farm income go down. In the final analysis, farmers will have to decide whether they want to be farmers or land speculators. If farmers, then public policy can aid them. If land speculators, their days as family-type farmers are numbered.

^{3/} Repeated studies by the U.S. Department of Agriculture and State Experiment Stations have shown that well-organized one- and two-man farms can achieve almost all the economies of size now available in agricultural production. See the summary of these studies by W. B. Sundquist, "Economics of Scale and Some Impacts of Agricultural Policy on Farm Size", paper presented at a Conference on U. S. Agricultural Policy, Center of Human Resources, University of Texas, April 30, 1971