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CORPORATE FARMING

By

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George Donohue, Philip M. Raup

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CORPORATE FARMING SEMINAR

Organized and Conducted
by
AGRICULTURAL EXTENSION SERVICE
AND
AGRICULTURAL ECONOMICS DEPARTMENT
OF THE
UNIVERSITY OF MINNESOTA

PURPOSE: To provide information on the economics of large scale farming, tax loss farming and corporate farming.

LOCATION AND DATE:

April 20	Litchfield
April 21	Detroit Lakes
April 22	Montevideo
April 23	Waseca

PROGRAM

Introduction and Introductions
District Supervisor, County Extension Work

The Corporate Form of Business
Dr. Willis Anthony, Professor, Agricultural Economics and Extension Economist, University of Minnesota

Large Scale Farming
Dr. Paul Hasbargen, Professor, Agricultural Economics and Extension Economist, University of Minnesota
Dr. Leonard Kyle, Professor, Agricultural Economics and Extension Economist, Michigan State University

Dinner

Tax Loss Farming
Dr. Leonard Kyle

Community Concerns
Dr. Paul Hasbargen, Dr. Philip Raup, and Dr. George Donohue

Minnesota Legislative Activity
Minnesota Legislator members of Interim Committee on Corporate Farming (Frank DeGroat, Interim Committee Chairman spoke at Litchfield and Detroit Lakes, Senator Jensen of Montevideo substituted for Senator John Olson at Montevideo; Representative Stone, chairman of the House Agriculture Committee spoke at Waseca.)

Alternative Policy Approaches
Dr. Vernon Ruttan, Professor and Head of Agricultural Economics Dept., University of Minnesota

Panel Discussion

INTRODUCTION

I. Background to Meeting

A. Concern over the corporate farming issue was evident by the several bills that were suggested in the last session of the Minnesota legislature. Hearings were held by both house and senate committees during the session and there is an interim committee which is holding hearings on this issue between sessions. A member of that committee will report on legislation activity as part of this program.

B. When a group from the University met with rural leaders around the state a year ago to inquire as to areas of interest for professional improvement training, the corporate farming issue was suggested as a topic in each area of the state. In response to these requests, the Agricultural Extension Service and the Agricultural Economics Department has organized this series of seminars.

II. The Issues Involved

A. Large scale corporate farms

The concerns about corporate agriculture are primarily concerns over large scale agriculture rather than concerns over the corporate form of business. However, since there is also much confusion about the corporate form of business as such, the first item in the program is there for the purpose of explaining just what a corporation is and what are its advantages and disadvantages. The major concern about corporate farms is in fact a concern that large scale farms will take over agricultural production therefore depriving many family farms and other rural community businesses of job opportunities. To what extent will large scale farms take over and drive our family farms out of business? That is, what are the economies and diseconomies of large scale farming. The second and third speakers will address themselves to this question--Dr. Leonard Kyle who has surveyed 50 large scale corn farmers in the cornbelt will discuss crop farms and Dr. Paul Hasbargen who has studied large scale feedlots will discuss livestock farms.

B. Other Issues

It is often charged that our tax laws give incentives to corporate farming. This issue will be explored to see if there are features of our income tax laws that encourage either large scale farming or the corporate form of business -- and to what extent the 1969 tax law changes these. Community concern over the economic and social welfare implications to rural America that are related to the changing structure of agriculture will also be discussed.

Alternative policy approaches to some of the issues raised will be outlined by Dr. Vernon Ruttan, Head of Agricultural Economics Department.

Each of you will get an opportunity to raise questions or other issues during the panel discussion.

THE CORPORATE FORM OF BUSINESS

By

Willis E. Anthony
Extension Economist, Marketing

Concerns with changing farm structure is sometimes expressed as fear of "corporation" farming and sometimes expressed as fear of "large scale" farming. Frequently the terms are used interchangably and one hears talk about policy to ban corporate farming and programs to control large scale farming.

As one considers ways in which public policy might be shaped to approach the changing organization of agriculture, the logic of analysis argues that the issues of corporation farming and large scale farming should be kept separate. We can have corporation farming without having large scale farming; and we can have large scale farming without having corporate farming. But for most people, the issues are closely tied. The pervasiveness of this tie in the minds of most people plus the historical record of business organization in the United States begs us to consider the relationship between large scale farming and corporation farming.

I aim to do three things:

1. To set out some concepts and possible uses of corporate farm organization.
2. To discuss the corporate form of business organization in the United States.
3. To sketch an outline of how this organization might fit agriculture.

The corporate form of American business organization is as common as the television commercials you watch. You all know what a corporation is and have often heard it defined. A standard textbook definition of a corporation is that it is an "association of persons into a legal unit with a distinct legal personality that enables it to carry on business, own property, and contract debts." This is what the law defines a corporation to be.

Corporations are not something which have existed from time immemorial. They came about by specific state legislation allowing people to band together in an organization called a corporation. The state charter carries with it no magic wand, and no secret and mysterious formula to suddenly transform an unprofitable enterprise into a gold mine. A corporation is simply one way for people to organize together to conduct their business affairs. Most states have passed laws enabling corporation,

because for some purposes there are distinct advantages to carrying on as a corporation rather than as a partnership or single proprietorship or some other way. Heated debate accompanied these statutes in the legislatures a century-and-a-half ago. Some legislators saw the kind of business structure they implied, and feared the vision.

The Corporation As a Farm Business Structure

If you have been reading the farm papers as I assume you have, you have read a dozen articles entitled "Incorporating the Family Farm", "Is a Corporation For You?" or whatever. I get the feeling that I have read the same one many times over. Assuming that we have all read these articles, I don't want to bore you with yet another one, but I will summarize what appears to be the significant advantages and disadvantages of incorporating the family farm businss.

A. First of all, let's look at the advantages:

1. Limited Liability. The most common reason given for incorporation in a Minnesota survey of farm corporations about ten years ago was the attribute of limited liability. This arises from the fact that the corporation is a separate legal entity existing apart from its shareholder owners. The liability of an owner is limited to the value of the stock which he owns. The most he can lose in a suit or an action against the corporation is the value of his stock. As a practical matter, this feature is very limited because in many cases of small corporations the lender will require the corporate officers to be personally liable for any obligations of the corporation. If a stockholder signs a personal guarantee for debts of the corporation, his liability is, of course, not limited to the value of his stock. Limitation of tort liability for damage or negligence can also be achieved by other means, such as contracting for insurance to cover loss.

2. Access to Capital. Another advantage often given for incorporating is access to capital. This relates to the limited liability feature. A potential shareholder, willing to invest or keep some of his capital in the farming operation, not interested in actively farming, may be more interested in so doing if his liability for corporate activities is limited to the actual investment that he has in the corporation. That is, if he is not jeopardizing other investments which he might have, he might be more interested in investing in the farm. In this way, a corporation may provide a good device for pooling family capital.

3. Taxes. There may also be some tax advantages to incorporating, particularly in income tax. While it is true that the corporate tax rate at low income levels is higher than the individual tax rate, the corporation rate at higher levels of income may be lower than the individual tax rate. Consequently, whether or not there is a tax advantage may depend on the level of earnings of the business. Furthermore, a corporation may be a device for distributing earnings over a larger number of people, each of whom could be in a lower tax rank than if all the income were taken by one individual. Thus, the corporate structure may be a tool for tax planning.

4. Employee Welfare. The corporation can become a part of unemployment and group insurance plans to cover employees as well as owner-employees. It may be possible to organize pension and retirement plans through which employees and employee-owners would not be taxed until retiremrnt. A salary may be stabilized to provide maximum social security benefits, in contrast to the annual variation in earnings for a farmer.

5. Estate Planning. A fifth advantage to incorporating, often cited, is in estate planning. If the estate is large, there may be advantages to transferring a part of it intervivosly. Since a man and wife can each give $3,000 annually tax free and have an additional $30,000 lifetime exemption, it is possible to transfer a substantial estate before death. Since the ownership of the assets in a corporation is represented by share of stock with specified valuation, it is possible to very conveniently make these annual estate transfers without having the cumbersome procedure of dividing real property or transferring parts of personal property. There are also estate planning advantages to the business from incorporating in that the corporation has a life as a perpetuating unit independent of the life of original incorporators or major shareholders. Thus it may be possible for the corporation to be a vehicle or tool for maintaining continuity of the farm business operation owned by several individuals or family members at the death of a major shareholder.

6. Records. Record requirements are often cited as a disadvantage to incorporating. I would rather consider them an advantage, since important records are required, and must be maintained by state law for the corporation. It is a powerful incentive to maintain a set of records of minutes and major business decisions that all too often are not kept.

7. Management. One of the advantages to incorporating is that the corporate structure is a management tool. The corporate organization requires that shareholders elect a Board of Directors, who in turn appoint the officers of the corporation. In a farm, all three groups may be the same individuals. However, the incorporation process requires the incorporators to think about the separate functions of each and requires the elction of a president, vice-president, the treasurer and secretary, and so on. In so doing many people find that they need to designate functions or duties for each of these officers to perform. Consequently, it is possible to divide the management tasks for a farm business, and allocate them to individual officers. This becomes more than a simple prescription on paper; it does become a powerful tool to divide management responsibility. Of course it would be entirely possible to do this simply by decisions among a group of people who are operating a business without incorporating. Nevertheless, very few farm businesses do this. Incorporation may provide such an opportunity.

B. Let's now look at disadvantages to incorporating:

1. Records. We have mentioned it before, but record requirments may be a disadvantage. If they are considered to be simply a nuisance and red tape, and are not used as a management tool, they can simply be an added chore. Detailed records are required for directors' meetings, shareholder's accounts, balance sheets, tax records, and so on.

2. Taxes. Taxation, which we have mentioned before, can also be a disadvantage. At lower income rates - the corporation tax rate does run higher than the individual tax rate. It is possible, however, for a small business corporation to elect to be taxed as a partnership, in which case, the taxes would be no higher

than if the business were not incorporated. Furthermore, if the corporation is not run at a profit; that is, if all earnings are paid out as expenses and salaries to shareholders, there is no reason for the corporation as a corporation to be taxed at all, or to have any net income.

However, some growth in retained earnings may be necessary over the long run to provide capital for equipment and other asset purchases. A corporation can also involve double taxation. If the corporation makes an income and pays it out to shareholders, the income is taxed as income to the corporation, and taxed again as revenue from dividends to the shareholders. Social security tax rates are higher. That is, the combined social security tax on the employer plus the employee - that is the corporation, plus the employees of the corporation, is higher than the social security tax rate for an individual farmer.

3. Cost. Clearly something that must be considered before incorporating is the cost of the incorporation process. Depending on the legal work involved and the amount of services that you are interested in having your attorney perform, it may cost as much as $500, in total, for incorporating a moderate-sized family farm.

4. Dissolution. In most instances, dissolution of the corporation is not simply a matter of stopping business. That is, there are specific procedures that must be gone through to formally dissolve the corporation, this may be a little bit more cumbersome and perhaps more expensive than breaking up a partnership.

C. Should You Incorporate?

There are both advantages and disadvantages to a family farm corporation. As I said before, you don't get a magic wand when you get the corporate seal. To be successful it is clear that a good deal of advanced planning of organization is extremely important. The objectives, the purposes, the capital structure, and so on, should be carefully planned. It has been said that in no field of the tax law is the opportunity to pack up and start over less readily available than in incorporating.

Further, a corporation by itself can't do anything that participants don't want to do. A corporation can't settle family disputes, although it may decrease the case of them. The corporate farm may not be a method or raising capital although it can be a useful vehicle for maintaining capital in the business. A corporation is not a cure-all for estate transfer problems, but it may make the transfer easier.

D. Some key questions:

There are a few key questions that you may find useful to consider if you are thinking of a family farm corporation.

1. What do you wish to accomplish? Are you interested in estate planning, in limited liability, in continuation of the business after death, in expansion and growth, in dividing management functions, and so on.

2. Consider all the possible ways of achieving your objectives. It may be that a simple estate plan or will, a sole proprietorship or partnership, a limited

partnership, a trust, a cooperative, or something else may accomplish the objectives that you have in mind.

3. What will be the impact of incorporation on your taxes? This will vary by the individual farm business, but you had better consider it before you incorporate.

4. If you see some advantages to a corporation, are the advantages worth the cost of incorporating? Again, this is something that has to be answered for an individual farm business, but it is something that you ought to consider before you pay your money for the fees.

Each of these questions has to be answered specifically for your individual business. In general it has been suggested that about a $100,000 level of investment is necessary before incorporation clearly pays. Again, speaking generally, the corporate form of organization appears to be the most advantageous for farms in which there is fluctuating income, such as in beef production. In most cases income taxes aren't likely to be altered plus or minus by incorporating for taxes to be the deciding factor.

Suppose that you answered in the affirmative to question number 4. The advantages to you appear to be worth the cost of incorporating. How do you do it?

E. How Do You Incorporate

There is little ambiguity on the issue. Most states require specific steps for the corporate charter to be granted. Generally, it involves the following:

1. You have to make the decision to incorporate. Having made the decision it is possible to file preliminary applications for a charter with the Secretary of State if you want to. The incorporators may want to make a free incorporation agreement indicating what their major rights and duties are after incorporation; and they may want to make other agreements beforehand.

2. You need to draft the Articles of Incorporation, the By-laws and any shareholders' agreements, contracts and other documents. Standard forms are available for most of these, but they may want to be modified for any particular situation.

3. The Articles of Incorporation must be filed with the Secretary of State, and the appropriate county office.

4. The Secretary of State issues the certificate of incorporation, or the charter, and the corporate life is begun. Usually at this point the bank account is also initiated.

5. Property and cash of share holders are exhcanged for shares of stock or notes or other securities such as bonds evidencing contributions by those who are incorporating the business.

6. Shareholders hold an organizational meeting. The shareholders elect the directors and the elected directors in turn, elect the officers who adopt the By-laws which determine essentially the rules of the meetings and the rules for governing the business, and the business begins.

F. Minnesota Statute Provisions:

State corporation statutes set forth the general requirements for incorporation are as follows:

There must be a minimum of three incorporators.
There must be a minimum of three members of the Board of Directors.
Directors need not be residents of the state, as is required in some state.
A Director need not be a shareholder.
Minimum paid in capital must be $1,000.
There is provision for perpetual life, in contrast with some other states where corporate life must be renewed periodically.
There may be non-voting stock.
Farm corporations are permitted.

The Corporation In The United States Economy

The simple structure for incorporating the family farm gives one perspective of corporate organization. It is a way of re-organizing the ownership of the business enterprise. But this does not give a perspective on the role of the corporation in American industry.

The corporate organization proved to be an effective tool for massing large sums of capital in a single business. It is difficult to imagine how the giants in the industrial economy could have developed in any other way. Hence, this structure has become the dominant form of industrial enterprise.

As the large-scale companies grew, management found it necessary to develop patterns of management control to cope with the massive units. The decentralized structure evolved. In a contempory large corporation, top management is fundamentally concerned about major capital and planning decisions. In which of many lines of enterprise should the company expand? Which division looks most promising? Which industry should the firm enter next? From which should it exit? With whom should it next merge? And so on. Operating decisions are made by group vice presidents in charge of individual lines of business, company plants, or whatever.

The corporate organization has fostered the decentralized structure. This has become a dominant institution in American business enterprise. It is a different institution from the kind of capitalism we know in agriculture and it is different from the model of an earlier United States economy.

Conglomerates and Agriculture

The large scale corporation could enter agricultural production in one of two ways: As an additional enterprise or through vertical integration.

One possible method of entry could be in the same way that the conglomerate firm enters many industries. That is, if it looks like a profitable investment for

the firm's capital, it may simply add another division. In this case, it would enter much the same input and output markets as any other farmer. The major difference would be the amount of capital under control and the scale of operations.

I believe there is a more likely method of entering agriculture for the conglomerate firm. Many have divisions engaged in processing commodities or supplying farm inputs. Consider the case of the agricultural processor.

There are several sources of pressure for closely coordinating production and processing of agricultural commodities. The retailer (in most cases, the super market) finds that it can engage in a far more rational and plannable merchandising strategy if it can engage in planning a price policy for the items that it sells in the store. To be able to program its price policy with respect to food it must be able to accurately gauge and plan on supplies in advance. In other words, it prefers to be assured of a given quality of meat of a particular cut at a specific price long in advance of the time that it is going to put that cut of meat on its retail counter. Since it is selling a broad range of merchandise, and is advertising what it is selling, and is attempting to build a specific and particular store image, it likes to be in a position of programming what is going to go across the shelf as far in advance as it is possible to do so. In the case, of items of substantial quality or price variability (such as meat and fruits and vegetables) it is willing to pay a premium, or--conversely--will offer a discount--to somebody who can't supply the quality and the quantity and the price in a manner in which it can be programmed into its enterprise. This puts pressure on the meat packer. He knows he can get a premium if he can supply a programmable commodity. Thus, he may find it desirable to build a feed lot next to his packing plant so that he can have closer control over the kind of cattle going through the plant and the flow of the cattle through the plant. Furthermore, if he can maintain an even flow through the plant he can probably lower his cost of operations because he can fully utilize labor and equipment over long periods of time. Thus, there are some clear advantages to vertical integration or by some other means securing the kind of supply he finds desirable. Hence, a meat packing division may get into farming by buying land and building a feed lot.

There are also some compelling pressures for closer coordination arising from agriculture. Farm enterprise specialization plus tighter input/output margins make income more vulnerable to relatively small price changes in any one commodity. An assured market is a valuable asset for a farm business. A production enterprise with this assurance has some advantages.

THE ECONOMIES OF LARGE SCALE LIVESTOCK FARMING IN THE SPACE AGE

By

Paul R. Hasbargen
Professor of Agricultural Economics
University of Minnesota

In examining one's competitive position for producing livestock or livestock products, three different sets of conditions should be explored. These are: (1) Advantages and disadvantages associated with the location of his business. (2) What resource mix is available and (3) What is the level of management skills.

The Countdown

Therefore, the producer of tomorrow, to be successful in a financial sense, must get the green "GO" sign on a number of "systems". On the front page of each of our livestock planning guides we show three different systems, Location, Resources, and Management. There is a check list of items for each of these systems that an individual producer should satisfactorily answer before launching an expanded program. For example, the following standards are suggested for cattle feeding.

Cattle Feeding - Should I Expand?

	GO	NO GO
Location	Near Grain and Feeders Mild, dry climate	Far from markets Flat land - high rain
Resources	Large feed supply High capital/labor	Small farm Low capital/labor
Management Skills	Feed costs under $17/cwt. Gains over 600 lbs/yr. Gross Margin per cwt of gain:	High feed costs Low ADG
	$23.00 on calves	$22.00 or less
	$26.00 on yearlings	$25.00 or less

The Pay load - How Large

If the farmer has a "GO" in all systems, how big a "payload" should he try to carry? Given an appropriate location and excellent management he can rapidly change his resource mix by gaining control over more capital. However, if he limits

the labor input to family labor, one man or one family can handle only so much. At todays higher capital/labor ratios the approximate size of different types of specialized farms that can be handled by one family are shown in Table 1 along with average labor requirements. Of course, the labor requirements per unit vary greatly among farms with different production systems, size of fields, weather conditions, etc. Normally those production systems with lower labor requirements have higher capital requirements.

The lower labor systems are not necessarily lower cost per unit systems. However, even if the cost per unit is the same under higher capitalization these systems give higher returns to their managers since more units are produced per man. Table 2 shows that farms with more capital tend to show higher profits. So there is little question in anyone's mind that as new mechanical innovations permit one man to handle more acres or more livestock, farm sizes will continue to grow.

But, what about expanding on the basis of additional hired men? Obviously, the manager who is capable of managing additional men as well as additional capital can increase his earnings by increasing the size of his business beyond the one man farm size.

To date the number of farmers who have been willing or able to do this has been limited. And available evidence shows little indication that the proportion is changing. Because of the more rapid increase in wages than in other farm costs, total hired labor on farms in the United States and in Minnesota has been dropping even faster than family labor. In 1959, 76 percent of Class I farms (those with sales of over $40,000) and 50 percent of the Class II farms (sales between $20,000 and $40,000) reported hired workers who worked 150 days or more. In 1964 these percentages were 71% and 38%. And hired workers as a percent of the total labor force is declining.

But certain types of farms lend themselves to industrialization more than do others. These are the farms where the production can be concentrated spacially and where technology has removed much of the production uncertainty. Given these conditions, superior management can take advantage of the latest production technologies, gain some production cost savings with larger size, and make additional savings in purchasing inputs and in marketing products.

Poultry farms and cattle feeding farms meet the above criteria well enough to show evidences of production concentration in larger units. Table 3 shows the proportion of total sales of each major livestock category that was accounted for by farms with over $100,000 in sales in 1959 and 1964.

The current farm census will disclose further increases in the concentration of production on large livestock farms. Probably close to 40% of all livestock sales will be accounted for by these large scale farms.

The Ballistics of the Beef Business - Our Competitive Position

Large scale feedlots have expanded very rapidly since 1964. In fact almost all

Table 1. Number of Hours of Work Required Under Typical Mechanization and Size of Enterprise and Potential Size of Specialized One-Man Farms.

	Hours per head or acre	Size of Specialized One-Man Farm
Hay	7	---
Corn Silage	8	---
Corn Grain	5	500
Small Grain	3	800
Dairy Cows and Replacement	70	40
Hogs	3	800
Beef Cows	8	200
Cattle Feeding	5	400

Table 2. Comparison of 1965-67 Inputs and farm profits of high capital input farms, high labor input farms, and high return farms with average of Minnesota Farm Management Association farms with complete continuous records for past decade.

Category	Farm Labor		Farm Capital	Farm Profits
	Family	Hired		
Average of 43 farms	1.2	0.4	$ 81,689	$12,443
5 high capital farms	1.1	0.8	$186.395	$17,222
5 high labor farms	1.3	0.9	$ 96,943	$14,015
5 high profit farms	1.3	0.6	$151,581	$26,358

of the very large expansion in cattle feeding since then has come from the increase from lots of over 1000 head capacity. These large lots accounted for over one half of total fed cattle marketings in 1969.

Since almost all the large feedlots are to the west and south of Minnesota the question arises as to the extent to which larger size per se adds to the competitive position of that area in cattle feeding. In a study that we made a few years ago we examined three possible sources of advantage--location, scale, and management--that the Southern plains area had over the Northern cornbelt. (For a summary of that study pick up a copy of MSU Report #77).

Location advantages were found to be the most important factor causing the more rapid growth of the cattle feeding industry in the southwest. These locational advantages gained from the more desirable climate and the nearer source of feeder animals gives the southwest a dollar a hundredweight of gain cost advantage over our area.

Management differences were found to be the second major source of cost and return differences when average returns from cattle feeding in the northern cornbelt were compared with returns to specialized feedlots in the southwest.

Size per se also gave an advantage to the specialized feedlots. Lower labor and facility costs would save about 60¢ per cwt. of gain for 2000 head capacity lots versus 500 head capacity lots. Some additional cost reductions are realized by going to 10,000 and 20,000 head lots.

However one very important advantage of size and specialization could not be studied--the savings realized in buying and selling as compared to the small operator. Potential savings in buying include a lower interest charge on capital as well as lower feed, feeder, veterinary and supply costs. Although some evidence was found that these existed, not enough data was available to make a specific estimate of these savings for larger lots.

A Colorado study did show that in 1964 only 4% of the feedlots under 500 head capacity paid less than 6% on money borrowed in contrast to 89% of the over 5000 head capacity group. The total range reported in interest rates paid that year was from 4.5% to 8%. This is enough to give rise to a full $1.00 per hundredweight of gain difference.

When I was in Texas last summer analyzing some large scale feedlots I found that they were enjoying some very favorable returns on the investment in commercial feedlots. These feedlots commonly took ownership of only a small portion of the cattle they fed. Cattle ownership, of course, had also been giving favorable returns. The sentiment that I heard was that 25,000 head was a practical sized business unit for North Texas. Last year feedlots over this size showed the largest percentage gain.

The Space Race Outlook

Labor inputs will continue to decline as wages and the reservation price on family labor continues to increase more rapidly than other input costs. Many livestock farms that now hire workers for 150 days or more will either increase their investments in material handling equipment or they will discontinue or cut back on

their livestock operations. On the other hand a small number of operators who are willing and able to effectively manage hired help will increase their livestock operations with hired workers, many of whom will be specialists in their fields.

Capital inputs will continue to increase quite rapidly, especially on a per man basis. The higher capital/labor ratio will enable the one family farm to continue to increase output. Many one family cattle feeding farms will move into the $100,000 sales category. However, capital requirements per farm will be so large that more and more operators will be looking for methods of capital control other than ownership. There will be increased use of the corporate form of business to bring in equity capital and to help in transfer of family owned capital to the next generation.

Management inputs will come from a broader base. That is, more people may be involved in decision making on a higher proportion of farms. Larger units will see more specialization by man with one person managing the livestock operation while someone else takes major responsibility for the crops. Outside specialists or consultants will be used more frequently. Some may serve on the board of directors - others on retainer fees. But, I believe that central management will largely remain in the hands of one of the owners. A major reason for this belief was in last Sundays Gospel lesson - John 10: 11-14 where Jesus was quoted as saying:

> "I am the good shepherd. The good shepherd lays down his life for the sheep. He who is a hireling and not a shepherd, whose own the sheep are not, sees the wolf coming and leaves the sheep and flees; and the wolf snatches them and scatters them. He flees because he is a hireling and cares nothing for the sheep. I am the good shepherd; I know my own and my own know me."

This we observe. And it suggests why hired managers are often given a "part of the action" in terms of performance bonuses or stock options in many businesses. It also suggests why we have not yet witnessed any increase in the number of farms operated by paid managers. The proportion of total farms operated by paid managers has remained under 1% for the past 20 years. For farms with over $100,000 gross sales the proportion was 13.1% in 1959 and 12.0% in 1964. (See Table 4)

Payload concentration will vary by type of farm. Poultry and cattle feeding farms will show almost complete concentration in large scale units. Hog finishing units will begin to show more concentration with the feeder pig producing units remaining as supplementary enterprises on smaller crop farms. Dairying like feeder pig production will tend to remain on smaller family units in the midwest but more of these will be organized as two or three man operations to permit more frequent relief from the milking routine.

Large Corporate "outside" firms will show more and more interest in agricultural production as that production becomes more industrialized and especially if it can be integrated into the processing and/or marketing stages. Money from Wall Street will be available to help finance expansion of successful units. But to be successful requires experience. And it is the farmers of today who have the experience -- not outsiders. And unexperienced or otherwise poorly qualified managers will not be

Table 3. Sales of farms with sales of $100,000 or more, reporting specified products sold, as a percentage of total for all farms, 1959 and 1964

Specified products	Sales as a percentage of total for all farms	
	1959	1964
Livestock and poultry sold alive, and their products sold:		
Eggs	10.1	36.8
Cattle and calves	22.7	32.8
Sheep and lambs	15.7	29.5
Chickens including broilers	14.8	23.3
Whole milk	7.4	10.7
Hogs and pigs	1.9	4.7
All Livestock	15.1	24.0
All Crops	17.7	24.4

Source: 1959 Census of Agriculture, Vol. 1, Ch. 11 and Vol. 5, part 7, and 1964 Census of Agriculture, Vol. II, Ch. 6.

Table 4. Farms operated by paid managers by specified value of sales, and their percentage of all farms in each sales group, United States, 1949, 1954, 1959, and 1964.

	1949		1954		1959		1964	
Value of sales	Number	Percent	Number	Percent	Number	Percent	Number	Percent
$100,000 or more	a/				2,618	13.1	3,761	12.0
$40,000-$99,999					3,064	3.7	3,021	2.7
$20,000-$39,999					3,384	1.5	2,781	1.1
$10,000-$19,999					3,192	0.7	2,663	0.6
$10,000 or more	12,247	2.5	10,400	1.8	12,258	1.5	12,226	0.3
$5,000-$9,999	4,881	0.7	3,385	0.5	2,494	0.4	1,423	0.3
$2,500-$4,999	1,475	0.2	2,018	0.2	1,611	0.3	856	0.2
$2,500-$9,999	6,356	0.4	5,403	0.4	4,105	0.3	2,279	0.2
Total $2,500 or more	18,603	0.9	15,803	0.8	16,363	0.8	14,505	0.8

a/ Blank spaces show data not available

able to show a profit in the agricultural business of tomorrow.

J. K. Galbraith in his "The New Industrial State" assessed the sweep of economic history from when land was limiting and therefore the source of economic power, through when capital was limiting to the present when management (in his terms, "technostructure") is limiting. In somewhat similar order we have seen that in United States Agriculture, labor was first limiting, then capital, and now management.

> The large family was an asset yesterday.
> The rich father-in-law was useful more recently.
> Knowledge and experience will be required for tomorrow.

THE ECONOMICS OF LARGE SCALE CROP FARMING

BY

Leonard Kyle
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For years I have watched farmers struggle with the problems of adequate business volume. This goes back to 1946 when I was a county agent in Ohio and extends through employment as a farm management extension specialist in Indiana, Illinois, and Michigan. When the opportunity arose for me to travel and study for a year I decided it was time I decided for myself what the prospects were for a truly large-scale industralized agriculture. The experiences of the last nine months have disturbed my thinking considerably. During July and August, I visited over 50 operating units in the Central Corn Belt with over 2,000 acres of corn and soybeans. Seven had over 4,000 acres of rowcrops. Two had over 8,000 acres of corn. Several fed over 10,000 head of cattle. About one-third of these were incorporated, all but one as family-held units. From my travels I have concluded we lead a rather sheltered, secluded life in the Midwest where smaller farms have dominated for a century. There is considerable prospect that the traditional one and two man farms are in for a tremendous competitive struggle in the years ahead.

Do We Have Any Big Farms?

Size is a relative concept which changes over time and has some relationship to each person's image of a benchmark. Farmers commonly think any farm bigger than theirs is big including those with large holdings. Most people accept all types of large scale organization from universities to business, but agricultural tradition emphasizes smaller economic organization as being more desirable. The Census has done a good job of obscuring the increasing concentration of agricultural production in fewer units.

In 1929, according to a special Census publication, ten farm units sold over $1,000,000 of products. A special effort was made to describe "Large-Scale" farming by analyzing 7,875 units which had over $30,000 value of products sold. This is comparable to $48,450 in 1964 or units only slightly larger than the 141,914 Census Class I farms. The Class I farms averaged over $105,000 value of products sold and had 44% of the total production. This data suggests that we had perhaps 125,000 units in 1964 of the same physical output as the 7,875 in 1929. This is an increase of nearly sixteen times.

The concentration of production is not uniform by type of farm or region in the United States. Table 1 shows the concentration of production within Class I

farms. This has increased dramatically in the last ten years. Note that six of the twelve Census classes had over 60% of total output within the Class I size group. In descending order these are vegetable farms (81.4%), other field crops (73.7%), poultry (67.9%), fruit and nut (67.6%), miscellaneous (65.4%), and ranches (64%). Farms with over $100,000 sales showed similar concentration of production but generally above the 40% of total level instead of 60%. This data shows that dairy farms, cash grain farms, general and livestock farms, which are predominant in Minnesota, are in the types which so far have production concentrated in smaller farms.

The regional concentration of large farms is shown by figure 1 in Agricultural Economic Report #175, ERS, USDA, "Our 31,000 Largest Farms." The large units are concentrated in the West and South. In California and Arizona 69% and 78% of the units had sales over $100,000. In Minnesota only 7.9% of the units had sales over $100,000. All of the Midwest is about the same ranging up to 19% in Iowa.

The study of the 31,401 largest farms, mentioned above, reports that these units produced 24% of the total product in 1964. In 1959 there were 19,979 similar units so the growth in numbers was 57% in five years. In 1964, 919 farms had sales over $1,000,000 and accounted for 7% of total production. This is an increase of 125% from the 408 farms of similar size reported in 1959.

What Does Data From The Internal Revenue Service Show?

In some aspects the published reports of the Internal Revenue Service give a better idea of the number and size of farm business units than the Census data. The data is not directly comparable with Census data but is very interesting. Although the business receipts reported for proprietors, partnerships and corporations in Schedule F income and does not include Schedule D capital gains, 1966 data reports 92,429 individuals, 23,112 partnerships, and 10,311 corporations, (125,852 total), with business receipts from farming of over $50,000. This group accounted for 43% of the total farm income for all reporting units. Perhaps even more interesting is the fact that 1,519 sole proprietorships, 406 partnerships, and 1,925 corporations reported over $500,000 of farm business receipts. Also, 597 individuals and 676 corporations reported over $1,000,000 of business receipts. If farms with over $100,000 of business receipts are tabulated only one in six is incorporated. It is only fair to note that corporations were classed according to the major source of income which may result in under reporting.

How Do Big Farms Get That Way?

Perhaps by now I have convinced you there are some large farms operating in the United States. How do they get that way? Since there is no good research on this perhaps I can give you a few ideas. Some are holdings which go back to pioneer days and include Spanish grants, railroad grants, investments by Europeans or purchases by wealthy industrialists of another era. New formations result from recent developments in land clearing, leveling, drainage or irrigation of land which was not previously suitable for crop production. In the Midwest the

Table 1--Concentration of total production on farms by type, 1964 Census of U. S.

Type	Class I over $40,000 sales	Large-scale over $100,000 sales
	(Percent of total production)	
1. Vegetables	81.4	67.1
2. Other field crops	73.7	49.1
3. Poultry	67.9	38.
4. Fruit and nut	67.6	46.7
5. Miscellaneous	65.4	44.6
6. Ranches	64.	46.5
7. Cotton	55.2	31.3
8. Livestock	46.8	26.8
9. General	33.6	18.3
10. Cash Grain	23.9	6.4
11. Dairy	23.4	9.9
12. Tobacco	8.2	3.9
Total Average	43.7%	24.8%
Number of farms United States	141,914	31,401
Minnesota	3,438	537

most common, although less spectacular, method is by growth and absorption of smaller units by purchase and rental. Of increasing importance is simply buying into the game in a big way as a diversification of investments. Many wealthy individuals and corporations have financial accumulations which need to be invested in new ventures. With the potential of manipulation found in farm income tax reporting and the prospects for continued inflation, many of these situations result in a major penetration into farming. With the ability to use 30 to 50 cent "tax dollars" these people can prime a new large scale farming venture which uses the latest technology. Very few people understand the current size increasing impact of related agricultural businesses involved in the processing and distribution of farm products. Those who do say it leads to larger producing units. Note the concentration in vegetables, fruit, potatoes, and poultry.

Research on Economies of Size

The past research on economies of size has been summarized in Agricultural Economies Report #107, ERS, USDA, by Madden. This concludes that one and two man crop farms are large enough to achieve all of the economies of size. However it does point out that total profits may increase for farmers venturesome enough to exceed this size. I have recently reviewed this publication and would not necessarily emphasize the same conclusions from the same data. The studies tend to show that wherever large units are studied (California crop and some large feedlots) no researcher really demonstrated that costs increased materially within the range studied. Much of the research on economies of size has been conducted by midwestern land grant universities who were interested in two and three man farm units and they really never studied extremely large units. This research concentrated on methods which were really only involved with internal operating efficiency and assumed free competition in prices paid for inputs and prices received for products. The more sophisticated aspects of external economies were completely missed. Thus most past research has not really studied large scale farms in a modern context. The advantages of volume discounts for inputs has been missed. Also the possible advantages in selling a larger volume were neglected both in potential price and marketing costs.

Opinions About Corn Farms With Over 2,000 Acres

I am still in the process of digesting the data I obtained on corn farms which produced over 2,000 acres. The preliminary results of my feasibility plans comparing 500, 1,000, 2,000, and 5,000 acre units have been given to critics for review. But I can share with you the points I learned in the process.

1. It is possible for some large units to save $10 to $12 per acre when compared with a 500 acre unit on the purchase costs of inputs. This does not include labor or borrowed money. Most people don't believe this is possible, but the managers of some large units say it is more than $10. They buy most items for a 20-25% discount. In my calculations this is a composite saving of $4.56 per acre for machinery depreciation based on less units per 1,000 acres plus buying at dealer cost rather than 10 to 15% over cost. Other savings per acre from volume purchases were estimated at $1.84 for single cross seed, $5.51 for fertilizer, and chemicals, and $1.35 for fuel, oil, grease, and machinery repairs. Except for the machinery the same amount of input was used per acre in the calculations. These prices were obtained by smart purchasing agents using all of their muscle and different angles, some which reduce the selling cost--truck lots, cash in 30 days, bids by letter, etc. Units with over 5,000 acres of corn can get this done without operating an input supply business. They can buy directly from the manufacturer or jobber often at prices lower than that paid by the local elevator or dealer. Smaller units must resell some inputs as a dealer.

2. Large units can sell corn for a 5¢ per bushel net advantage. The selling advantage is harder to document, but with 300,000 or more bushel of corn to market the local elevator is by-passed. The tandem trucks and full-time labor used in harvest are used to deliver corn to river or rail terminals during the winter for a very low out-of-pocket cost. In fact this system is much more efficient than the traditional community elevator and for awhile at least will enjoy the typical margin. On several of the units visited winter grain buying, trucking, and selling operations were the"winter" business venture.

Needless to say, both of these methods of operation will have considerable impact on the related agricultural businesses if farm consolidation develops further. Some farm supply firms are already hurting.

3. The third opinion gained is that the "real key" to profitable operation of large units is in the cost and efficiency of hired labor and management. This can be expressed in another way--can large units operate with enough internal efficiency to do nearly as well in labor and management costs as the most efficient two or three man family units? I can prove that some of them do. These are the good managers who can hire, organize, and handle hired labor including foremen and submanagerial assistants. The myth that agriculture can't be industrialized because of labor, weather, and the biological processes is a horse and buggy concept--only many farmers still believe it. Even with 30% higher wage costs large corn farms lose only three to four dollars per acre of their competitive advantage.

Some large farming conglomerates are having trouble. They thought size, big machinery, and plenty of consultants could make anything work. This is not true. Business units and sub-units must be put together with prior planning

and feasibility studies which are realistic. The management and labor must be utilized at a cost which is competitive with other producers especially smaller units.

What is the logic of owning big high capacity equipment and using it twelve or fourteen hours per day during peak seasons? This may be the limit of the productive effort of a paid employee even with an overtime wage formula, but how about a two shift operation? Nearly a third of the large corn units I visited use a night shift for everything except planting. This reduces machinery requirements by 30%. This saving was not included in my budgets.

Summary

The hard facts of life suggest that large crop farms of from 2,000 to 5,000 acres have some decided advantages for those people who can put the package together and manage the business effectively. This is a modern large scale industrial operation which needs proper planning and real operation finesse to succeed. The manager must handle the financial plan which includes some solid cash flow handling of operating expense and income as well as the long term investments in real estate and machinery. There are several ways to assemble the land without ownership.

Part of the skill required will be the purchasing agent job. Every effort must be made to buy as effectively as possible. Sometimes this will require new practices such as buying a complete line of machinery in one year. Buying on a contract-bid basis will be common. An additional dimension of the managers' job will be in selling. With bigger volume, new connections will be needed to get a better net price. Sometimes the farm will supply additional marketing steps at a lower cost than the traditional system.

One additional point should be made. Don't expect all of your smaller neighbors and some of the small town businessmen to like what you are doing. Chances are they won't.

TAX LOSS FARMING
BY

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I like to start from the basic premise that no tax is just or fair unless it is paid by someone else. What has evolved is a body of law and interpretation as used in income tax reporting to support the spending needs of our Government. This governs the business and personal practices of manipulation which are perfectly legal, but which are not well understood or appreciated by many common people. This is especially true of wage earners who have little room for maneuver and self-employed individuals of modest means who have low to moderate taxes to pay. The advantages of manipulation are easier for the wealthy to use.

You may not think it is fair for an individual to have interest income of $1,000,000 and no tax to pay; however this is perfectly legal and possible if the interest was from tax exempt bonds. This has not been modified in the new law. Livestock farmers loudly proclaim their lack of Government income support but overlook an estimated $500,000,000 tax advantage each year by way of the methods used in applying capital gains to breeding stock after the expenses of raising the animals have been deducted from regular income. The rules applying to conservation expenses have opened up the door to some of the nice tax manipulations in land development especially when used as a part of real estate buying-selling speculation for an individual or corporation in a high marginal tax bracket. Even the cost limitations for conservation expenses can easily be exceeded if a farm is operated in conjunction with a non-farm business.

Farmers concerns about tax loss farming are understandable. On many occasions they have observed reasonably wealthy business and professional people buying a farm as a rural residence and a tax shelter which happens in a free country. These might be units which skirt the "hobby farm" tag by IRS or a bona fide attempt to operate at a profit. Who can say what the intent was. Some attempts at a profitable investment are ill-conceived and unprofitable.

Any individual or business in a high marginal income tax bracket, especially those over the 45% level, are looking for ways to legally use "tax dollars" to foster a sound investment and delay the tax bite for another year. They are stupid if they don't. These people have sizable chunks of tax money to use if a suitable investment can be found and today there are brokers who will help set up the tax shelter business ventures. As I wrote this material, I heard an advertisement for the "Watergate Apartments," which are condominiums. One of the three or four items in the forty second ad was "it's a good tax shelter." I presume it is a low downpayment, high debt situation. For an individual in the 50% bracket a 6% mortgage only costs 3% and the prospects are good the property will become more valuable with inflation.

There is little question but that farming provides some unusual tax manipulation features which make it more vulnerable to penetration by investors than some other types of businesses. However urban real estate development, oil drilling, apartment houses and trusts all have their special features. The tax rules I have in mind are the cash basis for reporting, capital gains provisions for livestock and land and the special rules covering conservation and development costs. Farm businesses are much more complex now than when the tax rules were basically formulated. Also farm families have become more interrelated with the off-farm community with employment for wages and returns from non-farm investments. If small farmers were smart, they'd insist on an elimination of "cash" accounting and the capital gains provisions of income tax laws.

Off-Farm Income and Tax Losses

"The relationship between farm and off-farm income is probably more significant than has been generally recognized in understanding the U.S. rural economy. In 1963, individuals with farm income also reported off-farm income of $10.9 billion and capital gains of $1.2 billion." This is reported in ERS #383 "Farm and off-Farm Income Reported on Federal Tax Returns" by the USDA. It's hard to predict how many of these people you would classify as farmers but most think they are. Total Schedule F income from farming was about $34 billion for the same year.

In 1964, about 41% of the 3,130,000 individuals with farm income reported profits of less than $2,000 and another 35% reported losses. Fewer than 8% reported profits of $5,000 or more. The 118,000 partnerships reporting farm income had 20% with profits under $2,000 and another 20% with losses. Of the 12,305 corporations reporting farm income, 20% reported losses and 80% reported profits which averaged over $20,000.

In 1963, off-farm income and capital gains averaged only 36% as much for individuals with farm profits as for those with losses. However farm income and capital gains accounted for about half of the combined income of those with farm profits and were more important than farm profits for 38% of those reporting profits. One-fifth of the individuals with farm profits reported 60% or more of their combined income consisted of off-farm income or capital gains. Among individuals reporting profits, off-farm income averaged highest for those with the largest farm profits but accounted for a larger share of the combined income of individuals with small profits.

The Financial Situation of Individuals

All individuals (3,197,000) reporting farm income for 1963 were classified in one of five income groups by Reinsel for special analysis. More than a million

(32%) were classed as poor. They averaged only $5,590 of farm income and one-fourth averaged an additional $830 from off-farm wages. The middle and upper income groups (58%) included about 925,000 people in each and averaged $8,030 and $8,830 of farm receipts. In the upper group 71% reported wages or salaries averaging $5,400. The lower group averaged less than half this amount.

About 251,000 were classified as well-off. These people averaged adjusted gross incomes of $12,000 with farm business receipts of $17,090. Included were some 40,000 individuals who were truly well-off in terms of farm income. They reported average farm receipts of nearly $52,000 and farm profits of $10,000 or more. Although comparatively few in number, they accounted for 80% of those reporting farm profits of $10,000 or more; the remaining 20% were classed mainly as wealthy. Nearly 150,000 individuals, three-fifths of those in this income group were well-off not because of their high farm incomes but in spite of their low farm profits or farm losses. About 111,000 reported farm losses and more than 38,000 reported farm profits of less than $1,200.

The 66,000 wealthy individuals who reported farm income in 1963 can hardly be thought of as farmers, yet they generally reported income from sizable farm operations. Their farm business receipts averaged $40,130, far larger than the receipts of the other four groups. Nevertheless more than two-thirds reported farm losses. Wealthy individuals with farm profits averaged $52,770 in receipts and $13,270 in profits. Those with losses averaged $34,420 in receipts, but because their farm business deductions averaged $48,530, they reported average losses of $14,110.

From the above you might conclude there are many "tax loss" farmers and the problem of sorting them out is difficult. Only about 2,500 farm corporations reported losses.

Corporation vs. Individual Income Taxes

Contrary to popular belief the income tax laws do not especially favor corporations. In fact Harl has documented a comparison which shows the reverse until an adjusted gross income of about $60,000 is reached. Then the advantage may shift to corporations. The real force behind the Subchapter S law for reporting income tax was to make it easier (less tax) for individuals who wanted to form a corporation for estate planning purposes. In effect these rules permitted a small corporation to pass all income on to the individuals involved for tax computation if they thought it would save them income tax. It is even possible for a corporation to pay less tax if it reports under Subchapter C rather than S if the total income is high enough.

In the past one of the biggest advantages for corporate income tax reporting was in the use of multiple corporations so all would be taxed at the 22% level and each be able to accumulate $100,000 under the earned income rules

without tax. Both of these advantages have been put in limbo by the new law and it will take awhile to see what can be done legally to reduce the tax bite by using multiple corporations.

Growth As Manipulation

With the current rules for farm income tax reporting one of the best manipulation systems in farming is continuous growth. This utilizes continued high debt, land improvement and development, repeating depreciation on improvements by changing ownership within the family, increasing raised dairy or breeding herds by buying more inputs each year and counting them in expense. Unfortunately everyone can't or doesn't want to play this game.

Some Features Of The Tax Reform Act of 1969

Limitation of Losses. Several legislative proposals have been made to limit the use of "artificial" farm losses to offset large nonfarm incomes. These proposals have ranged from simple limitations on farm losses to more complex methods which would require special accounts in which to place "excess losses" and would limit their use to recapture of capital gains assets or the offsetting of future farm income.

Changes in Law. Both the House and Senate agreed that the tax treatment of farm losses should be subject to tighter controls. The House-passed tax reform bill provided that the total amount of losses could continue to be deducted but for taxpayers with nonfarm adjuster gross incomes (AGI) over $50,000, the excess of losses over $25,000 would be placed into a special excess deductions account (EDA). Gain on the subsequent sale of farm property would be treated as ordinary income to the extent of EDA balances. Amounts in the EDA would be reduced by farm income in a subsequent year. EDA balances would also be reduced to the extent they were used to offset capital gains on the sale of farm property. This approach prevailed in the conference committee and became the wording of the law, effective for tax years beginning after December 31, 1969.

Based on the combination of nonfarm income and farm loss tests of the law, precisely 3,928 tax returns would have been affected in 1966 according to the Internal Revenue Service.

Recapture of Depreciation. Formerly, livestock were specifically exempted from recapture of depreciation upon sale of property used in the business. The effect of this exclusion was to allow the conversion of ordinary income into capital gain with substantial tax benefits since depreciation was deducted from ordinary income taxed at regular rates, and gain from the sale of livestock was taxed at the lower capital gains rate. This created a disparity of treatment between livestock and other types of property used in a business.

Changes in law. The Tax Reform Act requires that gain on the sale of livestock be treated as ordinary income to the extent of previous depreciation deductions. The provision applies to years after 1969, but only to the extent of depreciation taken after 1969.

Holding Period for Livestock. Formerly the law allowed gain on the sale of livestock held for draft, breeding or dairy purposes to be treated as a capital gain if the animal had been held by the taxpayer for one year or more. It was charged that this period was not long enough to resolve the question of whether the taxpayer was actually holding the animal for the required purposes or whether he was holding it for sale in the ordinary course of business.

Changes in law. The House bill would have changed the holding period in order to qualify for capital gains upon sale to at least one year after the animal would ordinarily have been used for draft, breeding, or dairy purposes. The Senate changed this so that horses and cattle must be held for at least two years in order to qualify for capital gains treatment. Other types of livestock remain subject to the one year holding period in existing law. The Senate provision was adopted by the conference committee. The new provision affects livestock acquired after December 31, 1969.

Hobby Losses. The old law limited to $50,000 per year the amount of losses from a "business" carried on by an individual that he could use to offset his other income. This limitation, however, applied only if losses from the business exceed $50,000 a year for five consecutive years.

Changes in law. The new law changes this rule so as to disallow losses from activities which the taxpayer is "not engaged in for profit." The legislation further provides that if the taxpayer has profits in two of five years (or, in the case of the breeding, training, showing, or racing of horses, two of seven years) he is presumed to have engaged in that activity for profit and the Internal Revenue Service would be under burden to rebut this presumption.

Recapture of Soil and Water Conservation Expenses. Formerly, provisions of the law which allow the current deduction of certain soil and water conservation expenses and land clearing expenditures contained no provision for recapture of these deductions upon the sale of the land. It was believed that this, combined with the capital gains treatment allowed on the sale, make it possible for high-income taxpayers to make short-term-tax-motivated investments in farmland.

A high-income taxpayer could purchase farmland, make expenditures of this type in order to obtain current diductions from his nonfarm income, and then receive capital gains income when the land was sold, usually in a short period of time.

Change in law. The new law provides for the recapture of soil and water conservation and land clearing expenditures made with respect to farmland under sections 175 and 182 of the Internal Revenue Code. Gain on the sale of land will be treated as ordinary income rather than as a capital gain, to the extent of deductions allowed for the above expenditures made after December 31, 1969.

However, there is no recapture if the land has been held for at least 10 years. When land is sold prior to the end of five years after acquisition, expenditures are recaptured in full. For sales in the sixth through ninth year the amount recaptured decreased by 20 percent each year.

Summary

There is nothing fair about taxes and it will probably always be easier for the wealthy to manipulate their tax burden. In today's complex society farmers, farmers with off-farm investments and rural residents with farm and off-farm income are hard to separate out in the tax law. However Congress has tried to make some adjustments in the income tax law.

COMMUNITY CONCERNS OVER LARGE SCALE FARMING

By

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Concerns over large scale farming are broader than the questions as to who will control and manage our agricultural production resources. The broader concerns that I have labeled "community concerns" are those over the implications that large scale agriculture has to the economic and social welfare of the rural community.

These are concerns that small town businessmen will be bypassed, thereby causing the economic decline of small towns.

These are concerns that managers and workers for large scale corporations would have no interest in their local communities.

These are concerns that individuals lose some of their independence when they go to work for large scale organizations.

I have asked Phil Raup of our department and George Donohue, head of the Department of Rural Sociology to discuss some of these concerns.

COMMUNITY CONCERNS OVER LARGE SCALE FARMS

By

Philip M. Raup
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The main point to make is that above a certain size of farm, the crucial considerations are those that affect the community rather than those that concern the farm firm. We know that large farms can often produce efficiently and effectively. Above a certain size of farm the question is not how much more efficiency can be achieved but rather, what will be the impact on the community of a structure of farms this size. In other words, the emphasis shifts from efficiency and cost reducing considerations to the quality of life and the nature of the social relations in the rural community. I would like to talk about those for just a moment.

For one thing I think we have made errors in the past because we have had little experience with communities that were dominated by large farms. We know what happens when there are a few large farms, but we have little experience with the kind of communities that would result if there were only large farms. We do have some data from two rural towns in California that have been studied since 1945. One serves a community of small farms and one serves a community of very large farms. I visited these in March 1970.

In general, the big farm can get bulk discounts on quantity purchases in the local community, but only as long as there is a population of small farms to provide the majority of the trade that can support the distribution system, which then can grant bulk discounts. In a system where there are no large numbers of small firms, the distribution system cannot grant quantity discounts to a big purchaser if there are only big purchasers. So the whole distribution system changes, expecially as it affects the small towns and secondary cities. In other words, the mix of activities that take place outside the big central supply cities changes drastically. Local wholesaler and retailer levels disappear and you get a shortage of local tradesmen of all kinds. This was the most important thing that I observed in these communities in California.

In the town serving the big-farm community, there were few plumbers or electricians, no cement finishers, and few skilled tradesmen of any kind. The reason is obvious. There is no population of small tradesmen, small businessmen, small merchants, middle-income householders and small farmers to support that kind of trade structure.

Another characteristic that is often associated with communities dominated by a few large firms shows up in the education statistics. For example, in these two California communities of Arvin and Dinuba, data has been collected for over 25 years. In 1960, 70% of the children of the small farm community completed grade school and only 57% in the community dominated by large farms. And at the high school level, twice as many or 38% had completed high school in Dinuba, the small farm community, and only 19% in the community dominated by large farms. (This was Arvin, in Kern County, south of Bakersfield.)

The differences show up in another sense, in the quality of the local superstructure for public services. For example, there were twice as many miles of paved roads per square mile of area in the small farm community.

The differences also show up in many other fields. There are two newspapers in the community of small farms. There is only one newspaper and it is virtually a "company paper" in the community dominated by large farms. There is a radio station in the small farm community. There is no radio station in the large farm community.

In general the considerations that should govern, I believe, in our long range planning have less to do with the cost of production or efficiency in a narrow sense and more to do with the structure of the communities in which we want to live.

I think we can see this in the paper mill towns of northern Minnesota and Ontario. We can see it in the mining hill towns of eatern Kentucky or of Appalachia. This is what concerns people most, I believe, about big farms. It is not whether they will be efficient or whether they will compete successfully; it is what kind of communities do they generate and will these be desirable places to live and raise a family and to build a durable social structure.

COMMUNITY CONCERNS OVER LARGE SCALE FARMS

By

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Some people express concern that individuals employed in a large organization have less independence than those that are self-employed. Any discussion that the size of an enterprise, whether it is on a farm or in a non-farm area, is directly related to the amount of independence an individual has is open to considerable question. For instance it can be argued that in a small scale enterprise such as the main street business or the small farm enterprise or even the small industrial firm, the amount of prerogative or the amount of expression of rights that any individual has is more or less submerged in terms of the interest of the family that is running the operation. It is often said that there are more 40 year old kids in rural communities than in the large urban communities. The reason for this is that when one works for his father on the farm or in a main street enterprise, the decision making still largely rests with the father who is frequently quite elderly. As a matter of fact the 40 year old develops what is called a trained incapacity to make decisions because his parents are around to make decisions for him. The history of industrial development shows that the size of the enterprise is almost directly or positively related to the amount of freedom an individual has, the larger the industry the more rights the worker exercises.

I think that what we develop is the nature of relationships between individuals, between say a foreman and a worker on the line. And this is rather well spelled out in the prerogatives of the foreman as well as the prerogatives of the workers. For instance, years ago when we used the old guide lines of a family organization governing the early development of large scale corporation, individuals who didn't act in a way the boss wanted them to act were often arbitarily dismissed without any recourse whatsoever. Well, today, if an individual is doing something you don't like and you happen to be the foreman, you can't arbitrarily dismiss him unless it is in line with the contract. Some people say the union contract has taken away the individual's freedom but if you look at the union contract as a statement of relationship between the individual and the firm then it tends to give the individual a great deal of freedom of expression. You can't arbitrarily dismiss him--he has a right to a hearing, a grievence committee might hear him and say whether or not you were indeed correct in dismissing him or

POLICY ALTERNATIVES

by

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I have been sitting here trying to figure out what the total impact of what we have said this afternoon means as far as policy with respect to this issue of large scale farming. Let me first lay out what would seem to me, some general implications of what we have been saying and then say something about the specific areas of policy on which we ought to focus.

First of all, it seems to me that the concern with the corporate invasion of American agriculture is focusing attention in the wrong direction. The real issue is not corporate farming--but bigness. The growth of farm size cuts across the board, it involves individual family operations, it involves partnerships, it involves corporations. It is not confined to any one particular form of organization.

The second point that I would like to make is that in agriculture today, growth can no longer be viewed as good in and of itself. We have an American creed that has implied, in the past, that growth was a major objective of economic activity. There was a time when growth in the size of one farm implied no loss of opportunity for other farms to grow. In agriculture today this is no longer true. Everybody can't play the growth game.

Let me illustrate. We now have somewhere in the neighborhood of 35 to 40 thousand farms selling over 100 thousand dollars worth of farm products. If we were to organize our entire agriculture along these lines we could produce 80 to 90 percent of U.S. farm output on around a hundred thousand farms. And if the implication is 100 thousand farms in the United States, what does this imply for Minnesota? It implies that approximately 5,000 farms could produce most of Minnesota's farm output. Let me emphasize that I am not talking about the farm of the future. It will not take any more new technology to accomplish this objective. This type of farm is already here.

The third point that I would like to make is that as we consider the kind of economic organization of our agricultural industry that makes sense to us we must consider both firm efficiency and system efficiency. Increasingly, in our society, it is no longer sufficient to ask what is good for the individual farm; but we must ask what is good for agriculture as an industry. Many of you will recall back in the 1950's when president of General Motors became Secretary of Defense, he was asked about the military contracts that the Defense Department had with General Motors. His answer was that what was good for General Motors was good for the country. Well,

POLICY ALTERNATIVES

by

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I have been sitting here trying to figure out what the total impact of what we have said this afternoon means as far as policy with respect to this issue of large scale farming. Let me first lay out what would seem to me, some general implications of what we have been saying and then say something about the specific areas of policy on which we ought to focus.

First of all, it seems to me that the concern with the corporate invasion of American agriculture is focusing attention in the wrong direction. The real issue is not corporate farming--but bigness. The growth of farm size cuts across the board, it involves individual family operations, it involves partnerships, it involves corporations. It is not confined to any one particular form of organization.

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Secretary Wilson expressed his opinion "[illegible]" and vice versa" –
quoters do not seem to know this.

this view is no longer correct--what is good for an individual farm is not always good for the agriculture system. The right to engage in economic activity is a privilege granted by society--not a right. Society must always be in a position to evaluate the performance of the conomic units to which it has given these rights.

Now as I listened to these early discussions it seems to me that we could take off in one of two directions. Some of the discussions gave me great concern about the future of rural areas. My response was to ask why not impose absolute limits on farm size? Why not impose limits on who can incorporate? Why not impose limits on who can farm?

Other parts of the discussion lead me in the opposite direction. Why not do everything that we can to help farms get bigger to develop an industrialized agriculture as rapidly as possible? If in fact, we are heading in that direction, why go through the pain of adjustment? Why not adopt public policies that will move us as rapidly as possible to a highly concentrated industrialized agriculture?

My own response to these questions is that I would attempt to avoid either alternative. In our society we have much more sensitive and much more precise methods of managing the direction our economy should take. In our society the basic levers, the basic thermostatic or feedback devices, for regulating economic activity are through prices and taxes. With these devices we can change the behavior of the system by changing what it is profitable to do. This is clearly more effective than imposing extreme rigidities on the behavior of the entire system.

Given this perspective, I personally feel that we should consider policies to equalize competition between the family and larger than family farms. Our present system has a number of built-in biases which, in a sense, subsidize growth. If we want to equalize competition then we should give serious attention to the following:

First, to strengthening minimum wage legislation, unemployment compensation, and labor organization rights--to prevent the large farm from competing with the family farm on the basis of labor costs which do not reflect the true social costs of labor.

Second, we should impose realistic payment limitations under the farm commodity program. These programs as now constituted represent a clear cut subsidy to bigness.

Third, we should consider the kind of tax reform that would remove the tax advantages accruing primarily to larger farms. This involves a lower tax rate on capital gains then on ordinary income and cash basis of accounting. Also, it involves the tax advantages for conservation investments.

Fourth, we should adopt legislation with respect to pollution that would internalize the costs of environmental control. We should remove the privilege that firms now have of transferring the cost of pollution to society instead of bearing the costs themselves.

I would also emphasize, in conclusion, that most of the legislative activities that I have suggested are more appropriately accomplished at the national than at the state level. We cannot afford to adopt legislation in this state that reduces the competitive advantage of Minnesota relative to other states producing the same products. However, the same legislation implemented on a national basis would not adversely affect the competitive position of Minnesota or of Minnesota agriculture.

LEGISLATIVE ACTIVITY
A Summary of Remarks Made by Representative Frank De Groat, Ivan Stone, and Senator Jensen

There were six bills introduced in the House of Representatives and six bills introduced in the Senate. Each House bill usually has five authors and each Senate bill usually has three authors. Therefore, there were many legislators concerned with this issue.

The bills were assigned to the Agriculture Committee in both bodies and these committees in turn assigned them to subcommittees in both the Senate and the House.

Following many hearings of both subcommittees where they heard testimony from many individual farmers, farm organizations, University agricultural economists, businessmen, clergy, etc., the subcommittees decided upon a committee bill which went back to both Agriculture committees and onto the floor of both the House and Senate. This bill was designed to limit "foreign" capital from being invested in corporate farms in Minnesota while attempting to allow bona fide farmers to incorporate if they so desired. The proposed bill had numerous exceptions to the restriction on the foreign capital including exceptions for intensive poultry or livestock feeding operations.

The Senate debated the issue at length and, finally, amended the committee bill in a manner that everything after the enacting clause was stricken except for an amendment calling for registration or reporting of all corporations--domestic and foreign. This passed the Senate.

The House received the Senate-passed bill on the final day of the 1969 session. Regularly a bill must receive its second and third reading on separate days. Therefore the rule of the House had to be suspended to give the Senate-passed bill final passage in the House. This required a two-thirds approval of the body to suspend the rules. The vote fell slightly short of this, therefore, the Senate-passed bill died in the House.

The 1969 Legislature passed a resolution memorializing Congress (Resolution No. 8) to enact legislation limiting the right of non-farm corporations and individuals to write off farm losses against non-farm profits, for federal income tax purposes. Some limitations of this nature were enacted into law as a part of the Federal Tax Reformbill passed by Congress.

This resolution urging Congress to cope with problems of tax loss farming is positive indication that Minnesota lawmakers did, during the 1969 session, do

something in the corporate farming area.

The 1969 Legislature directed that the issue of Corporation Farming and Tax Loss Farming be studied during the interim by a joint subcommittee of both bodies.

To date the subcommittee has held several hearings on the issue and probably will report back to the full committee on their findings sometime prior to the 1971 session. The task of the subcommittee is to make such a report along with possible recommendations for action. It is not to draw up a new bill.