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Staff Paper Series

Staff Paper P73-15 May 1973

PUBLIC CONCERNS AND POLICY ISSUES ON CORPORATE AGRICULTURE

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STAFF PAPER P73-15 May 1973

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Staff Papers are published without formal review within the Department of Agricultural and Applied Economics.

Public Concerns and Policy Issues on Corporate Agriculture*

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At the outset it is important to recognize that the term "corporate agriculture" lacks precision. In popular usage it typically involves at least three connotations: (1) Large scale firms, (2) absentee owned or controlled, by (3) conglomerate corporations. While we lack definitive data on corporate firms in agriculture, the data we do have make clear the fact that the numerical majority of corporations engaged in farming in this region are relatively small scale, family firms with no more than ten shareholders.1/ And some of the largest farms in the region are not incorporated.

This body-count approach to the analysis of corporate farming is misleading. It obscures the fact that the number or proportion of corporate firms in agriculture is no adequate measure of their economic or political power. Although there are half a hundred corporations engaged in poultry production in Minnesota, for example, it is reported that the majority of the output in dollar value is produced by a half-dozen firms and processed

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* Paper prepared for a conference on "Who Will Control U.S. Agriculture?", sponsored by the Agricultural Extension Services of Minnesota, North Dakota, South Dakota, and Wisconsin, held at Minneapolis, Minnesota, March 28-29, 1973.

1/ A Minnesota law of 1971 requires an annual report from all corporations owning or leasing farm land. The first report, as of March 15, 1972, disclosed that in 49 percent of the 589 corporations reporting, the officers of the corporation and the members of the board of directors all had the same surnames. In an additional 23 percent of the corporations, no more than two different surnames were involved. It seems safe to assume that over two-thirds of the corporate farms in Minnesota in 1972 were family corporations, although a number of these are too large to be considered family farms.

by three firms. In vegetable processing, three firms also dominate the field in Minnesota. These data on concentration are reinforced by comparable data from California, Florida, and other states in which corporations play a much more prominent role in agriculture.

It is clear that we must look forward in time, and outside this region, if we are to benefit from an analysis of the policy issues that are raised by the expansion of corporate control in agriculture. Before doing so, it is appropriate to direct some questions about family farm corporations to our sponsors, the agricultural extension services in this region.

The majority of these family farm corporations are still "first generation" corporations, in that the officers and boards of directors typically include the original incorporators. They have yet to face the problems of corporate succession in ownership or in management. The problems that will arise when minority stockholders find themselves "locked in" have in many cases not been anticipated. We can expect to find a number of family corporations in difficulty when they face the problem of stock conversion for the heirs of present stockholders who want out.

This will involve two types of problems: A liquidity problem, and a valuation problem. Raising the capital needed to buy out disaffected shareholders will strain the cash flow and credit resources of the family farm corporation. While painful, this may not be the most serious problem. The greater difficulties seems likely to arise in arriving at a valuation for the corporate stock. A failure to include a specific buy-back provision for stockholders who want to sell out may be one of the greatest weaknesses in the articles of incorporation and by-laws in many family farm corporations.

The capitalization question raises another issue. In advising farmers to expand the size of their operation we have often failed to consider the question of transfer of control at time of death. As a result, a number of our larger family farms are too large to be transferred to a single proprietor under our existing credit system. In effect, the search for economies of size has organized the farm out of the family farm class, without making it clear to the farmer that this was going to be the result. For both corporate and our larger noncorporate family farms, we can anticipate acute financial problems when the time comes to transfer control to the next generation.

Turning now to non-family farm corporations, it is crucial to the discussion to emphasize that much of the growing public concern about corporate agriculture will be misinterpreted if attention is confined to firms engaged in agricultural production only. One of the most serious defects in the limited data we do have on corporate control in agriculture is that the data are in general confined to firms directly engaged in farm production. Land holding corporations not directly identified with farming were explicitly omitted in the 1968 study of corporate farms by the U.S. Department of Agriculture. The definition of corporate farm land used in the 1969 Census of Agriculture effectively eliminates many corporate holdings of rural land from Census enumeration. As a result, our data on corporate control of <u>farm</u> land seriously understates the extent of corporate control of <u>rural</u> lands.

The significance of this understatement is emphasized by the rapidly increasing use of rural land for recreation, residential and related non-farm uses. It is these rural non-farm uses, in fact, that have stimulated

much of the national interest in land use planning, during the past decade in which corporate farming enterprises were increasing most rapidly. To the non-farming majority of our population, corporate control of agriculture gives rise to concerns that are not confined to food production.

A dramatic example is provided by the Williamson Act in California, which seeks to preserve agricultural land use and open space by granting tax relief to property owners who will contract with the counties to retain their land in its current use for ten years. In return, the land is assessed at current use values, rather than at market price. This law has been widely cited as a model for other states.

In 1971, one-fourth of the 5.4 million acres entered under the Act in California was in Kern County, and just under one half was in Kern and Fresno counties. The ten largest beneficiaries, in descending order, were:

Tejon Ranch
Kern County Land Co. (Tenneco)
Southern Pacific Land Co.
Michigan-California Lumber Co.
J.G. Boswell Co.
American Forest Products
Standard Oil of California
Giffen, Inc.
Irvine Co.
Getty Oil Co.

Over one-fifth of all land entered under the act in California was held by these ten owners, for whom tax assessments were lowered by $50 million through entry under the act, and taxes by an amount estimated at $4 to 5 million annually.2/

2/ Power and Land in California, Robert C. Fellmeth, Editor, The Ralph Nader Task Force Report on Land Use in the State of California, Washington, Center for Responsive Law, 1971, Vol. I, p. II-37.

The legislative sponsor of the act, John Williamson, was state assemblyman from Kern county when the act was adopted by the Legislature. It was strongly supported by the companies and firms that are now its major beneficiaries. The bulk of the land entered under the act is not in the path of urban development, and there is little evidence that the act has preserved open space of interest to the urban and non-farm population (one of its stated aims).3/ It stands as a testimony to the power of large corporate land owners to secure tax relief at the expense of the other taxpayers in the counties, municipalities, and school districts concerned. And it illustrates the potential non-farm impact of corporate agriculture, in a manner that falls outside conventional discussions of the impact of corporations in farming.

It is also testimony to the short-sightedness of the policy position of the U.S. Department of Agriculture, which has all but abandoned its traditional broad interests in rural American land ownership patterns. The present exclusive concentration on commercial agriculture may ultimately prove to be disastrous for federal farm policy. The Department of Agriculture has not sponsored any national research study of rural land ownership for over twenty-five years.4/ There are no national data to report the massive changes that have taken place in rural land ownership

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3/ Ibid., pp. II-24, II-38.

4/ The most recent national survey of rural land ownership in the United States was based on a sample of farms drawn from the 1945 Census of Agriculture, which was taken only four months after the end of World War II. See Buis T. Inman and William H. Fippin, Farm Land Ownership in the United States, USDA, Miscellaneous Publication No. 699, Washington, D. C., December 1949.

since World War II. At a time of rising demand for national land use planning we have a data black-out on rural land ownership. It is difficult to see how an ostrich-like attitude toward land ownership changes can serve commercial agriculture. It is clearly an attempt to sweep the non-commercial farm problem under the rug. And it is certain that this lack of data is contributing to the insistence with which both farm and non-farm people are asking: "Who owns rural America?"

Let us turn now to the explicit subject of this paper. One of the major incentives for corporate investment in agriculture is provided by the prospect of capital gains in land. This stimulus is strongly supported by our tax laws, and accounting practices. A model for the exploitation of this opportunity is provided by the integrated firm that can mobilize capital from several links in the integration chain and transfer it through the chain for investment in the land-using unit. Any resulting appreciation in land values over and above development costs will be taxed at capital gains tax rates when the land is sold.

The now-classic model is the integrated ranch-feedlot-slaughtering plant firm. This firm can operate the feedlots and slaughtering facilities as producers cooperatives, pushing profits down the chain and into heavy investments in irrigation, breeding stock, and land development activities. Similar potentials are available in forest production, through the forest plantation-pulp-mill-paper-mill-publishing chain. Some of the most extensive activities of this kind concern irrigation development for intensive fruit and vegetable production. A well publicized example is Tenneco, Inc. which in the words of N.W. Freeman, its chairman, is following a systematic policy "to buy, develop and sell land on a regular basis."[5/]

5/ Quoted in The Washington Post, December 23, 1971.

These potentials for intra-firm capital transfers result in the final analysis from tax and accounting advantages that are bid into the price for land. As a result, we see a capital structure in agriculture that is a reflection of institutional defects and privileged treatment for certain classes of investors. Farm land and ranch prices are bid up out of all reasonable relationship to capitalized net earnings in the hands of single proprietors. Corporate activity has been especially prominent in ranching areas. Ranch lands in western states are currently selling, for example, at prices ranging up to $1200 to $1500 and above, for the land needed to support a cow and her calf for one year (a cow-calf unit). This is approximately double the price that can be justified by long-run profit and loss calculations in the range-cattle industry. While the cause and effect relationships are complex, it is noteworthy that some of the largest farm land price increases in the United States in the past two decades have occurred in those states in which corporate farm activity has been most pronounced.

An analysis of the impact of the massive structural changes now occurring in American agriculture will be clearer if we review the principal ways in which individuals have traditionally shared in our national well-being. This sharing takes two forms. In economic terms it is a composite of opportunities to share in:

a) income flows

b) wealth stocks

The recent emphasis on productivity gains as a basis for increasing claims on income flow has diverted attention from shifts in net worth,

and shifts in participation in capital gains. This diversion is of major significance for all proprietary businesses and especially for agriculture.

Throughout our history, owner-operating farmers, small proprietary businessmen, and small manufacturing firms and industries all have had an opportunity to share in both the income stream and in increases in net worth or in capital gains. The Fifth Amendment to the U.S. Constitution, guaranteeing that no person shall be deprived of life, liberty or property without due process of law, has been given an implicit interpretation in the popular mind that extends it to the guarantee of an opportunity to share in the national capital gain. Throughout the history of the United States these opportunities have been widely diffused, though not equally shared. The rise of giant corporations after 1890, the revolution in retailing that came with chain stores in the 1930's, and more recently the decline in number of farms and growth in corporate farming have combined to reduce drastically the number of enterprises that share in the ownership of the nation's wealth.

For the majority of Americans today, the principal way in which they can participate in capital gains is through ownership of their residences. The decline in the proportion who can participate in the creation of new wealth through ownership of their farms or places of business and employment is perhaps the single most important structural change in the American economy in the Twentieth Century.

In theory, it is possible to increase opportunities to share in wealth through stock ownership in business firms, participation in pension funds that invest in equities and provide for variable-payment annuities, participation in mutual life insurance programs, and in related ways. Other

methods could include participation in retirement programs in which rental rates reflect construction costs at the time when the individual earned the majority of his income, and not at the time when he retires. In fact, many people do not have these opportunities. This is especially true of those who rent their residences; those who have limited pension rights, or pension rights other than Social Security; those who have little or no life insurance; and those who have no shares of stock in business firms. In an industrial society, these are the modern "dispossessed."

Farm owners, like many other small businessmen, have traditionally shared in increases in the national wealth through their ownership of real estate. This has provided a major incentive for long-term investments, in an industry subjected to high levels of economic, biologic and climatic uncertainty. It has given a needed sense of stability, and has provided an expanding credit base that has been a major element in the ability to finance technological change.

A serious problem may arise in connection with the distribution of benefits from expected increases in land values. Dramatic changes in land values are usually associated with economic development. These result from industrialization, transportation system improvements, agricultural productivity increases, and growing competition for land for residential, industrial, commercial, and recreational purposes. These increases in land value can be a source of great benefit or great harm. If land value increases benefit a relatively small number of owners, the pattern of income and wealth distribution becomes much worse. Political revolutions and economic distortions are often associated with concentrations of wealth of this type.

On the contrary, land value increases can promote rapid development if the benefits of gradual increases in land values are widespread throughout the economy, and received by a large number of relatively small-scale owners of urban and rural lands. Anticipation of these increases can exercise a powerfully stimulating force in promoting rapid economic growth and development. The importance of this type of incentive for careful and intensive development of rural and urban lands is increased by the fact that a major part of capital gains due to land value increases is not a "real cost" to the economy, but is a "transfer payment." The land owner who anticipates a part of his reward through gradual increases in the value of his land is being "paid" in a manner that does not involve the use of scarce resources. He may be motivated to work hard and carefully in the development of his land, and be satisfied to receive a part of his reward through capital gain.

In contrast, if the farmer cannot benefit through gradual increases in the value of his land, he is denied one of the most powerful incentives for hard and careful work. To replace this incentive, he will demand a higher income, a part of which he will spend on the purchase of goods that do require scarce resources of steel, copper, aluminum, electricity, petroleum, or skilled labor. Resources to produce these goods are scarce and expensive. As a result, a system of rewards in agriculture that relies exclusively on money income or wage payments requires a larger supply of producer and consumer goods that use scarce raw materials than is necessary if a part of the incentive for the farmer can be offered through a gradual increase in his wealth, represented primarily by his

land. In a narrow sense, no man can subsist on capital gains. But he can derive from the expectation of these gains a powerful incentive for productive effort.

Do we really want to destroy this incentive structure in American agriculture? Do we want to concentrate opportunities to share in increases in the national wealth in land in the hands of a few large corporations? Is it in the national interest to force the agricultural labor force to resort to strikes in food producing firms in order to obtain through the income stream what they have lost through the wealth flow? This is one of the major policy issues that is focused for us by the increasing role of corporations in agriculture.

A frequent reaction to empirical studies of economies and diseconomies of large-size or corporate firms in agriculture is to point out that we really do not know what economies of size could be achieved by very large firms, because we have studied so few of them. It should be added that one reason is that it is extremely difficult to obtain the necessary data from large firms. They usually will cooperate only with research workers or institutions known to be favorably disposed toward large-scale undertakings.

One consequence is that the empirical data that are available tend to be focused on the economies of large scale production. There is often a clear implication that if more studies in greater depth of larger firms were made, they would show the existence of even greater economies of size.

It is rare to find any studies in the professional agricultural economics literature that focus on the diseconomies of large-scale

agricultural firms. One reason is embedded in the nature of large-scale firms: They are often created in order to internalize economies of size, and externalize the diseconomies. A study of their performance that is guided by a narrow focus on production economics and conventional theories of firm behavior is virtually certain to overstress economies and understress or ignore any diseconomies. We have extensive and repeated studies of the costs to agriculture of reduced use of agricultural chemicals, or shifts in fertilizer formulas and rates of use. There are virtually no studies of agriculturally-induced pollution that relate amount of pollution to size of farm.

It is also rare to find any discussion of the diseconomies of large-scale firms in the agricultural press. These farm publications succeed or fail on the basis of advertising income. Their major advertisers are firms whose sales pitch is directed to the large farms. Some of the advertisers are component parts of corporations that are themselves in the corporate farming business.

It is highly unlikely that these corporate advertisers influence editorial policy directly. It is also highly unlikely that farm press editors will risk antagonizing their advertisers by pressing an attack on large-scale or corporate farms.

As a consequence, we have a farm press today that is homogenized, flaccid, slick paper, better suited to the coffee table than the kitchen table, and devoid of controversy. At a time of drastic change in the structure of American agriculture we lack farm press editors who are aggressive, abrasive, and willing to rock the boat. In this time of greatest structural change in American agriculture, the farm press has relegated itself to a huckstering role for agribusiness.

One of the possible areas of diseconomy in large scale production in agriculture concerns the trade-off between long-term and short-term investment strategies.

In a socialist firm (where the state takes the profit and economic rent) the workers are unable to capitalize investment income into take-home private wealth. If the workers are to receive any benefit from investment they must receive it as take-home pay at the time the income is earned.

If the workers have any ability to influence investment decisions of the firm they will attempt to insure that investment is directed into short-term activities with high pay-off. This has happened in the worker-managed firms in Yugoslavia.6/ It also helps explain why control over the amount that can be paid out for wages (the wages fund) is retained by central government in the USSR, even for those firms that have been given greater authority to make investment decisions.

This type of control can be exercised (or at least attempted) in a centrally planned economy. In a market economy made up of large firms, the workers have an alternative in that they can strike, or otherwise attempt to compel the firm to pay a higher proportion of income as wages. The result is similar to that attempted in a socialist firm. Worker demands for higher wages, to offset their inability to share in investment income, will tend to force the firm to shift investment into short-run, quick-pay-out channels. Or it will discourage the firm from undertaking long-term, slow-pay-out investments.

A shift from proprietary firms to large corporate firms in agriculture is thus likely to influence the allocation of investment funds in agriculture,

6/ E. Furobotn and S. Pejovich, "Property Rights and the Behavior of the Firm in a Socialist State," Zeitschrift für Nationalökonomie, 1970, 30, 431-454.

to the disadvantage of long-term investments. It is typically pointed out that the large corporation has a superior ability to raise capital in agriculture. It is not typically recognized that one price that must be paid for this superior capital-raising ability is some loss of control over the firm's capital investment pattern.

As a consequence, the firm is likely to seek relief in the form of tax concessions, guarantees against risk, or increased power to control markets, in order to enable it to undertake long term, slow-pay-out investments.

This leads to a policy question: From the point of view of the total economy, is it cheaper to encourage long-term, slow-pay-out investments by permitting workers to share in investment income and capital gains? Or is total welfare advanced further by an incentive structure that places greater stress on current take-home pay and requires subsidies from the national government to encourage firms to undertake long-term investment strategies?7/

A partial answer is provided by studies of incentive investment schemes in Europe, designed to promote investment in lagging agrarian regions. The incentives in the South of Italy, for example, had their greatest effect on large-scale firms making high profits on the basis of short-run investments. Government incentive schemes did little to promote small or medium-size firms, or firms attempting to achieve long-run improvements.8/

7/ This question is raised by inference but not discussed in Armen A. Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," Am. Econ. Review, Vol. LXII, No. 5, Dec. 1972, p. 787.

8/ OECD, "The Effects of Government Incentives on the Locational Attitudes of Entrepreneurs," Working Party No. 6, Industry Committee, Paris, 25 May 1972, p. 25.

A further possible diseconomy concerns potential loss of support for research and development effort. One of the key lessons learned from public support of research and development efforts is that the most durable progress is made when there is duplication of effort. An "all eggs in one basket" policy is bad for several reasons:

1.) It increases the price of error

2.) It runs the risk of individual and institutional commitment to one crop, one product, or one (or a few) techniques of production, thus increasing the probability of institutionalized pressures to conform.

Private firms may be large enough to afford to invest in research and development efforts. But it is highly unlikely that they will be large enough or far-sighted enough to follow a research and development strategy that calls for duplication of effort.

An agricultural production system dominated by a small number of large firms is unlikely to command political support on the scale necessary to maintain a vigorous program of public investments in agricultural research and development. More succinctly, voters are not likely to elect representatives who vote for large appropriations to land grant institutions for research that is primarily useful to Tenneco, ITT, J. G. Boswell Co., J. Paul Getty, Purex, United Fruit or Coca-Cola.

An agricultural structure dominated by a few large firms, even though only in certain sectors, regions, or products is thus likely to result in a drying-up of support for agricultural research financed by tax revenues. And it is also likely that the large firms that remain in the industry will themselves be unwilling to replace this public-sector research effort.

Turning from investment policy to price policy, the available evidence is much stronger for the existence of pricing diseconomies in large-scale or conglomerate agricultural firms. This evidence concerns the loss of precision in the operation of that part of the information system involved in factor and product price structures. The larger firms fall victim to what Lloyd Best has called the "incalculability" of their internal operations.9/ Their pricing decisions as products move up the production chain become echoes of corporate policy, lacking reference to external markets for price determination. Recent studies of large conglomerate firms in the United States by the Federal Trade Commission illustrate the point.

The FTC published on January 3, 1973 the concluding part of its study of nine of the largest US conglomerates. In summarizing this report, the senior author, Stanley E. Boyle, lists the following defects of large conglomerate firms:10/

1. Conglomerates do not increase the efficiency of their component parts. Changes made usually affect auditing, insurance and legal services - activities that relate to control, not to production, research and development, or marketing.
2. They result in loss of public financial information, through lumping sales and profits data.

9/ Lloyd Best, "Outlines of a Model of Pure Plantation Economy," Social and Economic Studies, Vol. 17, No. 3, September 1968 (Univ. of the West Indies, Institute of Social and Economic Research), p. 289.

10/ See "Big is Neutral," The Economist, January 13, 1973, p. 40, and letter to the Editor, "Conglomerate Mergers," by Stanley E. Boyle, The Economist, February 3, 1973, p. 6.

3. They make it impossible for firms not already in the industry to determine prospects for profitability.
4. They obscure from stockholders the internal information that would enable them to judge quality and effectiveness of management.

Conglomerates thus have a distinctly anti-competitive effect.

Our state corporation laws, financial disclosure requirements, and accepted accounting practices all stem from a period in our history in which the dominant criterion was protection of the investor, or creditor. The public interest is very badly served by these turn-of-the-century rules. Specifically, the merging of corporate firms, especially from dissimilar fields, has these effects:

1. It is more difficult to determine efficiency of resource use in alternative production fields, or using different techniques.
2. Price data frequently result from internal decisions, and it is often impossible to refer to competitive markets for comparisons.
3. Opportunities are created for the use of a wide variety of accounting tricks to mask true profit and loss situations. Inefficient parts of the conglomerate are thus insulated from the corrective influence of market forces, and can be continued long beyond the point at which changes should have been made.

One consequence of present trends in American agriculture is the increased prospect of a three-part structure that will be surprisingly similar to the structure of agriculture in the Soviet Union. That nation's agriculture is characterized by three types of firms:

State farms

Collective farms

Private plots

It is not fanciful to point out the parallel between this structure and an emerging US structure comprising:

Large industrial-type corporate farms

Family-type corporate farms

Part-time and subsistence farms

If this structure develops it will be subject to the same defects that now plague agriculture in the Soviet Union, namely:

1. Bureaucratic rigidity in management
2. Insensitivity to market demands, reflected in efforts to dominate markets rather than respond to shifts in consumer tastes
3. Defective price signals
4. Destruction of tenure-based incentives with a parallel rise in worker frustration, alienation, and unrest
5. Increasing frequencies of theft, vandalism and deficient maintenance of equipment
6. Rising costs of policing, inspection and quality control
7. A production cost structure in which transaction and supervisory costs assume a dominant role

If this structure emerges in American agriculture, it will be farm people themselves who have played a major role in the development of policies that are propelling us toward large corporate farms. They do this by demanding the continuation of a series of policy measures that includes the following:

1. Preferential capital gains tax treatment for land and livestock
2. Insistence on the maintenance of a cash-basis accounting option for income tax reporting
3. Insistence on the maintenance of an option to mix farm and non-farm income in determining taxable income for federal income tax reporting
4. Opposition to proposed ceilings on government farm program payments

These examples of favored treatment for agriculture are of minor benefit to family-type farms, but of progressively increasing benefit to wealthy non-farm investors or large-scale and corporate farms. There is one iron law of farm policy: You cannot aid family farms by income tax policy if the income tax is progressive. Any preferential tax treatment bestows its greatest benefits on those with the highest incomes. It is ironic that family farmers have provided much of the voting strength for the continuation of these policies that discriminate against them.

We return at this point to our reflections on the importance of equal opportunities to share in the national wealth, as well as in employment and income. We have inherited the ethic and the institutional structure of an economic democracy based on a widespread diffusion of both economic and political power. Rewards in this economy have come through sharing in the income stream, and through the right to share in expectations of increase in the wealth stock.

We are told that rights to share in the national well-being in the future will depend on contributions to productivity increases. This has a hollow ring in farmer ears. No major sector in the American economy has

contributed more to productivity increases in the past quarter century than agriculture. And almost no sector has shared less in rewards through the income flow.

If corporation and very large-scale farms take over in American agriculture it will not be due to reasons of superior efficiency in production. These reasons are questionable at best, and of minor importance if valid. The compelling reasons will be related to a redistribution of rights in the American economy that makes it necessary to command economic and political power on a scale that can paralyze economic activity, in order to exact higher rewards through the income stream. If corporation farming does eventually dominate the rural scene, it will do so because management and workers in agriculture have concluded that only in this way can they mobilize political power to control prices and secure higher incomes. But it is almost surely true that, if this occurs, the public good will suffer. When labor and management collude in price and market dominance, we achieve private gains and public losses.

This is the key issue involved: the restructuring of political power as it is affected by rights of ownership. There is still time to influence the direction of that restructuring in agriculture, but the time is fast running out.