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1 Costs and Returns: Economic and Accounting Concepts

9 A New Approach to Estimating Agricultural Costs of Production

15 The Adjustment of Nominal Interest Rates to Inflation: A Review of Recent Literature

27 Role of Government in a Market Economy

30 Economic Analysis and Agricultural Policy

33 Agricultural Research Policy

# **Agricultural Economics Research**

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# In This Issue

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The first two articles in this issue discuss costs-of-production (COP) estimates, the first highlighting conceptual problems and the second proposing an approach that resolves some, but not all, of the problems. The difference between the proposed approach and most other research proposals is that legislation requires that estimates be calculated, whether or not the conceptual issues have been resolved.

The main conceptual issue arises in assigning a value to agricultural land, an important component in COP estimates. Economic theory indicates that the opportunity cost of specialized inputs cannot be calculated independently of demand, and thus, of product price. However, if the product price is set to cover the cost of the specialized input, the following three issues which Harrington identifies in the first article arise: (1) circularity (do production costs determine product prices or vice versa?), (2) potential cost-price spirals, and (3) escalating land values. Harrington further illustrates the distortions that inflation, income tax considerations, and the use of credit may introduce to land values, to interest costs, and, consequently, to COP estimates.

Hoffman and Gustafson, in the second article, address Harrington's second set of issues by propos-

ing that COP estimates separate current costs and returns from longrun costs and returns. However, they do not resolve the valuation of land issue, but instead apply the longrun real rate of return on assets invested in agriculture to the current market price, which could be influenced by the forces Harrington identifies. But, Hoffman and Gustafson's format clearly isolates this imputation and others from cash incomes and expenditures.

In COP estimations, as in some other economic applications, analysts attempt to remove the effects of inflation and temporary fluctuations from the nominal interest rate. One line of economic reasoning, that of employing the rational expectations hypothesis, does imply small fluctuations in expected real interest rates. However, high real interest rates, by historical standards, have persisted for some time.

In the Research Review section in this issue, Sundell summarizes the literature on the determination of real interest rates. He concludes that real interest rates have been quite variable because of slow adjustments of wages, prices, and output to changes in the nominal money supply.

**Lorna Aldrich**

# Contents

- 
- 1 Costs and Returns Economic and Accounting Concepts

*David H Harrington*

- 9 A New Approach to Estimating Agricultural Costs of Production

*George Hoffman and Cole Gustafson*

## Research Review

- 15 The Adjustment of Nominal Interest Rates to Inflation A Review of Recent Literature

*Paul A Sundell*

- 27 Role of Government in a Market Economy

*Reviewed by Stan Daberkow*

- 30 Economic Analysis and Agricultural Policy

*Reviewed by Allen B Paul*

- 33 Agricultural Research Policy

*Reviewed by Lyle P Schertz*