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DISCUSSION

J. N. LEWIS—*Department of Trade*

Mr. Gruen always takes a keen enjoyment in demolishing preconceptions. This is fortunate for us, since in any science there is always room for and benefit from the contribution of individuals with a flair for setting people free from stereotyped thought patterns. In his paper today, Mr. Gruen has played this role very provocatively and has subjected to critical scrutiny a number of propositions rather fashionable amongst us, such as that War Service Land Settlement has been a major influence towards greater investment, that accelerated depreciation for tax purposes has also imparted a major stimulus, that farm credit facilities are deficient and the like. He even at one stage took up the question whether investment is a determinant of the growth of output, but fortunately put that one back undamaged.

For my part, I still find myself standing somewhat apart from him on his general conclusions. I agree that we must not neglect longer-term measures for enlarging investment opportunities, such as basic and applied research, but I can see no danger in also focussing our attention upon *ad hoc* schemes to make it easier for farmers to take advantage of existing opportunities. The achievement of an average rate of expansion of about two per cent annually will probably call for vigorous measures along the whole of the agricultural policy front and it is therefore to be regretted that, after pointing out in his opening remarks that the institutional framework conditions to a large extent the problems of agricultural capital formation, Mr. Gruen, in his conclusion, seeks to shift attention away from the institutional constraints, such as credit terms which are poorly tailored to agricultural requirements, or uncongenial land tenure and taxation conditions.

On the question of accelerated depreciation for tax purposes, Gruen's view is that the effectiveness of these incentives is open to some doubt. It is, of course, impossible to demonstrate in quantitative terms just what has been the effect of accelerated write-off provisions on investment levels, but I believe there is a case for presuming they do have a substantial effect. If, as he suggests, most farm investment is financed out of current income and if our credit authorities are content that this situation persists, then anything which allows more capital improvements to be financed out of a given before-tax income could be important.

It may be useful, even if not quite correct, to consider the effect of accelerated depreciation as somewhat analogous to a price reduction for capital goods. This viewpoint is not altogether unreasonable since I suspect a good many farmers tend to work out the "effective" cost of capital improvements by deducting the tax saving from the purchase price and either to ignore or to discount heavily the effects on their subsequent tax liabilities.

The virtual price reduction will be greater the higher the marginal tax rate and the greater the difference between the normal and the special depreciation rate. It will be substantial in the case of those capital improvements which are allowable 100 per cent deductions and

quite large enough to be significant for items subject to special 20 per cent depreciation (especially the longer-lived assets). Moreover, quick write-off reduces risk premiums.

I certainly would not claim that the special depreciations are sufficient inducement in themselves, but I believe they have more influence than Mr. Gruen acknowledges. They could, of course, be made more effective if more than 100 per cent could be written off, that is, if a system of investment allowances were introduced similar to that which has been used from time to time in the United Kingdom. Even if accelerated depreciation had not been a major stimulant in Australia, therefore, it would not follow that we should devote less attention to tax incentives to investment.

In my view the suggestion that War Service Land Settlement has been an insignificant factor in postwar investment overlooks the fact that many of the holdings settled were developed from unproductive Crown lands and from lands previously used at only a fraction of their capacity. Furthermore, major developmental projects of this type pointed the way to similar investment opportunities for private firms and individuals. It is fair to say that Coonalpyn Downs and the Esperance district project may never have come into being but for the example of WSLs developmental authorities on Kangaroo Island and in the Mount Many Peaks and South Stirling districts of Western Australia.

I have confined my comments largely to the policy aspects, but this is by no means because the remainder of Mr. Gruen's paper is less successful in stirring up issues for discussion.

D. R. MUNRO—*Bureau of Agricultural Economics*

The continuing need for a high level of farm investment is widely accepted by agricultural economists. Most long-run measures for expansion of agricultural production are likely to be capital-demanding.

Mr. Gruen could not be expected in the time allotted to provide a detailed discussion of the investment requirements of particular rural industries. However, some discussion of this aspect would have been welcome because of its close connection with what, I feel, is one of the most important contributions of his paper. This is his contention that increasing income differentials between pastoralists on the one hand and the remaining group of rural producers on the other can have important effects on the process of capital formation.

The use of overall aggregates to trace trends in farm investment may conceal important changes taking place in the capital structure of Australian agriculture. Attention is often directed to the height of *total* farm incomes and to the height of *total* farm investment. The fact that only some farm incomes may be high and consequently that only some farm investment may also be high is often neglected. This neglect can and, I feel does, lead to a lack of appreciation of the basic problems of those individual rural industries where returns may not be high.

It could be argued that since a freely operating price system is the appropriate mechanism for the efficient allocation of resources the existence of wide income differentials may call for some fundamental adjustments in the structure of Australian rural industries. This conclusion

would follow from the ordinary criterion of economic efficiency that new investment funds should flow to those industries where marginal returns are highest; but it overlooks the point that some industries are more adversely affected than others by such national problems as inflation and balance of payments difficulties and by the means adopted to overcome them. Equilibrium analysis upon which the conclusion rests, must try to account for disequilibrating factors. It may well be that in the absence of such problems returns on a given amount of investment in some present low income farms may be higher than in alternative outlets. Moreover, the price system is not the freely operating mechanism that is often implied and in one important field it is scarcely allowed to work out its effects at all. This field is the balance of payments. For example a continued deficit is prevented from affecting either the level of money incomes and employment, at least seriously, or the rate of exchange. Under such conditions, distortions in the relative profitability of investment can be expected. Thus, investment in some rural industries may in fact appear relatively unprofitable at present cost-price relationships. On the other hand, the appropriate criterion of profitability from the national viewpoint can scarcely be regarded as *present* cost-price relationships since these are indeed one of the basic causes of Australia's balance of payments problem. In fact, it appears that this problem may prove insurmountable without some change in Australian costs relative to those overseas; and any criterion for judging relative profitability of alternative investment opportunities from the national viewpoint should make some allowance for such possible changes. Appropriate measures could then be adopted to see that new investment is profitable from the individual farmer's short-term viewpoint.

Mr. Gruen tends to underestimate the effect of some government measures in stimulating agricultural investment and considers that the effect on investment of special depreciation allowances has probably been small. I cannot agree with him on this point; but I do feel that if special depreciation allowances are to be criticised, the essential criticism of them as a major incentive to farm investment is not that they may have been ineffective but that they provide uneven assistance. Farmers who have little income available for investment after meeting necessary living expenses gain little assistance from such allowances; and these farmers probably have the greatest need for assistance in order to break through those barriers to increased efficiency imposed by the lack of capital resources. Although Mr. Gruen at least implies that we have adopted "broad sweep" measures when something more is required, I feel that if he had developed this criticism of depreciation allowances, he would have been able to integrate it with his valuable contribution on the effects of increasing income differentials between broad sectors of rural industry.