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# TAX POLICIES: IMPLICATIONS FOR U.S. AGRICULTURE

## HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

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WEDNESDAY, FEBRUARY 13, 1985

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION
OF THE JOINT ECONOMIC COMMITTEE,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10 a.m., in the Memorial Arts Center, Brookings, SD, Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senator Abdnor.

Also present: Dale Jahr, professional staff member.

## OPENING STATEMENT OF SENATOR ABDNOR, CHAIRMAN

Senator ABDNOR. The Subcommittee on Agriculture and Transportation of the Joint Economic Committee will come to order. I certainly want to welcome you all here today, who are vitally interested in this subject of taxation as it relates to agriculture.

This is getting to be an everyday occurrence with me. This is my third big meeting on agricultural problems in the last 3 days. We started out with this week with our committee's kickoff, rearing on the subject of rural America and its problems, last Monday in Freeman. It was a full-day session and well over 400 people there. I need not tell you about the big hearing and meetings we had out in Pierre yesterday, not by my committee, but we participated in it. It was an excellent day.

Today we want to follow with another hearing on the Joint Economic Committee. As long as I have the staff here, I thought it would be an excellent opportunity to discuss a topic that has been close to my heart and I feel quite strongly about, and I'm sure that you do, too.

Before I go any further, I want to tell you that this committee, the Joint Economic Committee, of which I'm vice chairman—the chairman is Dave Obey of Wisconsin—is made up of both the House and Senate. You all know the South Dakota State Legislature and the Governor will be coming to Washington within the next 2 weeks. I think and I know they certainly deserve a forum to be heard by Congress, and for that matter, by the White House and by the national media and all of Washington's decisionmakers. Because of that, and as vice chairman of the Joint Economic Committee, I'm arranging to give them that opportunity. They're going to appear at the Joint Economic Committee meeting. It's either going to be February 25 or 26, which ever best works out for them. It's my understanding it will be joined by 10 other States, and this should be an excellent opportunity to get our story told. I contacted the chairman of the committee, Congressman Obey. He was in full agreement that the Joint Economic Committee should provide the bipartisan forum of these legislators to take the center stage and give Washington their ideas.

As of just about an hour ago, I arranged for another major hearing that I think is of vital interest for all of you and maybe you would like to discuss it today. That's the matter of motor vehicle logging, recording your miles everytime you make a trip. It's been a big issue with me. I guess I was the first one on the opening day of Congress to introduce legislation to do something about it. I've had numerous conversations with the Treasury Assistant Secretary for Taxation, Ronald A. Pearlman. We've come a long ways in making them give on the regulations, but I still don't like them. I'm still going to move the first opportunity I have toward complete repeal. I don't want you to quit keeping your miles until I get that done. We're working on it. I'm taking this opportunity to bring in a number of tax experts, I think it's set up for March 6. It's going to be before another committee that I chair, a subcommittee on appropriations which I have 68 agencies under me, and it just so happens that one of them is the IRS. So I will be having a meeting with the Director along with tax experts throughout the United States, therefore I understand this, and I hope we get some added fuel and added ammunition to move quickly to get rid of that piece of legislation. Technically it should come out of the Finance Committee, the Finance Committee that makes the tax rules. It's my committee on appropriations that funds them to carry them through. I sometimes add a few things that I'm not supposed to do, and they all agree with me that we can get it done. That should be an interesting session.

I know it must sound like I spend all my time in committees, and I guess I do because that's where the work is done. That motor vehicle legislation and logging all of your miles has stirred up more disgust among the people of the United States than anything I've known. Because of my first bill, we have had hundreds of letters from all over the United States encouraging us to keep going with it.

Again, I want to bring this subcommittee to order and I want to particularly thank Joe Stewart, who is director of the Memorial Arts Center, and all the officials of the center and State university for providing these fine accommodations for today's hearing. I want to give a special word of thanks to Mr. Mark Edelman for taking care of all the arrangements here. I just couldn't be in as many places as I needed to be to set up these meetings. We are appreciative of that good help.

I welcome our prestigious panel of witnesses who have taken time out of their busy schedules to share their expertise and experience with us. Particularly I want to give them a warm welcome and also to our guests in the audience. It's my hope if time will permit us, to hear from each and everyone who desires to express their views on this subject for the record. Just seeing this many people here taking part in a public policy process is, indeed, gratifying to me. It tells me I'm on the right track.

On Monday of this week we had, as I said, another large turnout for a hearing focusing on the outlook of the South Dakota economy, and there we had I don't know how many people participating, but we had a crowd of over 300 people, and, of course, yesterday was our big rally in Pierre, and I think it was more than 6,000 people, the papers are saying, that were there.

This year I'm vice chairman of the Joint Economic Committee. In that role I'm in charge of congressional oversight of national economic trends. We keep tabs on the economic growth, job creation, productivity, the effects of fiscal and monetary policy, inflation, international trade, the value of the dollar in foreign exchange and all the implications accompanying that. My biggest role of all, as far as I'm concerned, is paying attention to what I call the forgotten economy. I discovered that the day I went on that committee several years ago, that the leading economists and the bureaucracy of this country seem to forget about the rural economy, because it makes up a small part of the overall economy in the total figures.

Rural America is the forgotten economy whose contribution we can no longer afford to overlook. President Reagan, while he boasts that America is back, he's correct on that if you look at the overall picture and all the vital signs that go into the economic picture, the figures are there. We're in the third year of economic growth, but let me tell you, I know and you know rural America is not a part of it and they're not back to normal by any means.

At last Monday's hearing in Freeman, we had the opening kickoff of my national rural initiative, and for the next session of Congress, that's one of the main topics this committee will be considering. I'm going to preside over an extensive series of hearings on all facets of the rural economy from economic development to health care and transportation systems to education. This comprehensive assessment will allow us to evaluate the strengths and the weaknesses or rural America and enable us to formulate situations and solutions, hopefully, to our problems.

The economic foundation of rural America, of course, is agriculture, and today we're here to discuss how taxes affect agriculture. This topic is very important, too, because a major tax reform movement is sweeping the country. A couple of weeks ago I was back in the State to discuss the Treasury Department's new tax simplification proposal, and we discovered considerable interest in that among the people. Then in the State of the Union Address the President has given it his blessing, and I'm sure we'll see movement in that direction on tax reform and tax simplification. It probably won't be a major consideration until the second year of the session of Congress. If all industries would analyze how they're affected by taxes to the extent we today are examining agriculture, I'm convinced the end result will not only be a fair and better tax system, but greater economic prosperity, as well.

There are three subjects that I wish to cover today. First, our tax system has several general features which deserve discussion. They include tax rates, tax deductions, depreciation schedules, investment tax credits, capital gain treatments, and the income and expense accounting. The next subject is tax sheltering. This is a much misunderstood topic, because one person's tax shelter may be another person's very necessary investment plan, but what we are really concerned about is abusive tax sheltering. In 1983, the Internal Revenue Service identified over 335,000 potential abusive shelters. Fortunately they aren't all in agriculture, but there are many in agriculture and we are concerned about that.

Tax shelters affect farming in two ways. First, tax shelters rob the U.S. Treasury of billion of dollars each year. This adds to the Federal deficit which, in turn, contributes high interest rates and the high value of the U.S. dollar. These are the two factors I think are hurting farmers as much as anything I know of and help make for the low prices.

Second, abusive tax shelters in agriculture have contributed to overproduction and lower prices and have led to tax loss farming practices where bona fide farmers trying to make a profit are competing with all farm investors who operate in the red intentionally to reap the benefits from the Tax Code. We've done much research into this subject, and this is based on a survey of IRS returns, and the results of this research actually surprised me, and I think would outrage the farmers and ranchers and above all taxpayers, in general, to learn the true extent of tax sheltering abuse. Tax returns in 1982 with farm losses exceeding $200,000 showed all farm income averaging $568,000. The average farm loss deducted was a whopping $410,000, meaning those so-called farmers had an average total income of $158,000 instead of what they should have. You just don't throw away $400,000 just because you found a way to tax shelter it, and above all, in the field of agriculture.

These facts lead to the third point of today's discussion. I would appreciate your views on legislation that I have introduced which would limit the amount of farm loss which could be deducted against nonfarm income. I propose losses be capped at $23,600 or the U.S. median income, and that figure was in 1984. It may be a little more this year. If such a law was enacted, the U.S. Treasury would gain about $2.6 billion alone, just in agriculture shelters over 3 years. Before I proceed with this legislation, I need to evaluate further the effects of this proposal, and your observations will be extremely helpful to me today.

Time permitting, I would also like to discuss the new IRS rule requiring you to maintain the mileage log for your business vehicles. I was the first in Congress, as I said, to introduce legislation prohibiting this rule from going into effect, and we are making headway and we're going to continue to, on this subject until we get it repealed or amended to something we can live with.

I've taken a lot of time I know in my opening statement because we do have so much to discuss. Now I want to turn to our witnesses. I would remind all of our panelists to limit their oral remarks because their prepared statements will appear in the record in its entirety. Everything that we hear from our witnesses will be on record. It will be in transcripts that will be taken back to Washington and made a part of the record. That's what I like about this subject we're discussing and making it official, because really it has been the forgotten economy, and I want something on record that I can turn to when we really get into the discussions of this subject.

For our first witness this morning, we thought it would be appropriate to start out with our secretary of agriculture, Marvis Hogen.

However, I don't think he's in the room. In this case we will start out with a gentleman who has a great overview on the problem. He's a public policy economist here at South Dakota State University and has been helpful in arranging this meeting. I'm going to call on Mr. Mark Edelman at this time.

## STATEMENT OF MARK A. EDELMAN, AGRICULTURE AND PUBLIC POLICY ECONOMIST, SOUTH DAKOTA STATE UNIVERSITY, BROOKINGS, SD

Mr. EDELMAN. Mr. Chairman, it's certainly my privilege to address your distinguished committee on the profound challenges facing South Dakota agriculture and some of the possible impacts of the tax policy proposals that are before you in Congress.

First, let me reiterate that my assumed role as an educator is to assist in clarifying problems, outlining alternatives, and discussing probable consequences. Now, having said that, let me confine my remaining remarks to the nature of the agricultural problems as they relate to tax policy and the current stress in the agricultural sector.

Very simply, as I view the situation, there's a short-run versus long-term problem. The short-run problem is perceived by many farmers is how to stay in business another year. The long-term problem is viewed by many in agriculture as who should own the land and what type of structure should agriculture be. Let's look at both of these, because there may be some inherent contradictions in how we define our tax policy to foster or to attempt to solve these two problems.

My view is in spite of all management attempts to survive, in all likelihood we are likely to see an increase in the number of acres available for sale in the land market of many midwestern States. The normal annual rate of land transfer during 1975 was about 3 to 4 percent.

Senator ABDNOR. Is that 3 percent a year?

Mr. EDELMAN. 3 to 4 percent.

Senator ABDNOR. For over how long a period?

Mr. EDELMAN. Over much of the 1970's. The normal amount of land that moves through the land market during the 1970's was about 3 to 4 percent of the land each year. So as a result of that, as a result of the current economic situations, we're expecting in many cases that that 3 to 4 percent might double. Some of my colleagues in neighboring States in Iowa, for example, are expecting even higher rates than that. So that raises a new policy problem. How much agricultural land should be available for sale at any one time and who should be allowed to purchase it?

I think this affects the long-term structure issue of agriculture. What should the structure of agriculture be? The long-term concern has its philosophical roots in agricultural fundamentalism, and that is the belief that the land ought to be owned by those who will till the soil. On the other hand, we have the contemporary view of market-oriented philosophy, to sell land to the higher bidder in spite of buyer occupation or residence.

Who will buy the land in 1985 and 1986 is a question or issue that is now coming up to the forefront. I think we have probably three types of people that will be in that land market. We have the low debt farmers with cash that are interested in buying land for future expansion as cheaply as possible. We're likely to see an increase in any entrance in agriculture in terms of bargain land prices and bargain machinery prices that may give rise to a new generation to entrance in agriculture, and many of the successful farmers in the sixties and seventies were those that bought it at the end of the depression. In addition, a growing number of agricultural lenders and private investment firms are entertaining discussions on how to package agricultural land for national investment market purposes and nonfarm investment.

So this raises the structure of agriculture issue. I think in addition, one farm management option available to high debt operators or one means of lowering their debt service requirements for those high debt operators is to take on new partners with capital, and thus reduce their debt service requirements and transfer the return to the debt over to return to net worth by taking on new capital partners. These two things in tandem imply the tax changes, changes in tax policy that would limit nonfarm investment would also tend to reduce the capital available for high debt farms prior to foreclosure or reduce capital available to purchase land in the land market.

Now, in contrast to that, that's the short-term stress situation. In contrast to that, we have the long-term structural issues, that there are many who believe our national tax policies give preference to nonfarm investors and that our policies ought to foster moderate size pastoral family membership. I think, Senator, your research on this issue highlights some of these issues. For example, we know feed cattle numbers have been declining in the upper Great Plains and they've been increasing in the southern Great Plains, and that many of the commercial feedlots in the southern Great Plains cater to tax shelter investments, while in the northern Great Plains our structure of agriculture up here is such that we have more moderate sized, diversified farming operations that feed cattle. So while it is difficult to separate the impacts due to regional resources available, economic efficiency and demand differences, tax policy has nonetheless been one of the factors that is involved in this operating environment.

Many in my profession debate whether or not tax policy is neutral or not. I guess my point is we usually define neutral as our tax bill minus 10 percent. There never will be a fair and equitable tax system that will be acceptable to everyone. I view the question as what type of agriculture do we want and what tax rules would be acceptable to Congress and still head us in that direction? Do we want to disburse land ownership among farm and nonfarm people? Should land be owned by those who farm it? Is it all right to have land held by a few people or corporations? Does land ownership constitute control? Does the current financial stress in agriculture take precedence over our long-term land ownership objectives? I think, I'm afraid what I'm doing here today is raising more questions than I'm answering, but I hope that maybe by doing this, that we help set some of the framework for the discussion that will occur the rest of the day.

Finally, let me raise one additional point. In a recent 17-State survey of farm policy attitudes of farmers that we participated in, the message on the budget deficit came through loud and clear. According to 72 to 87 percent of the producers in all of the States, balancing the budget is a worthy national objective. That doesn't surprise me. We asked some more detailed questions on how we thought they ought to do it that provides some interesting response.

Senator ABDNOR. What was that poll?

Mr. EDELMAN. A 17-State survey on farmer attitudes toward farm policy options in 1985. We asked them one question on whether or not, how they viewed our budget deficit situation, and, of course, 72 to 87 percent of the producers think balancing the budget is a worthy national objective as a philosophy. Then we asked them how they thought we ought to do it. We had 55 to 72 percent in all States agree on across-the-board cuts, even if it meant cuts in farm programs. We had a plurality of 27 percent to 48 percent in all States that generally disagree with proposals to freeze expenditures and raise taxes. I guess the sum result of the questions we asked on budget policy was that farmers tend to favor expenditure cuts and only raising taxes as a last resort. I guess that's the preferred approach.

I certainly want to commend you, Senator, for your attempt to gain greater visibility for the impact of tax policy on agriculture, and I wish you much success in taking the message to Washington. I have more comments I'll include in my prepared statement.

[The prepared statement of Mr. Edelman follows:]

## Prepared Statement of Mark A. Edelman

Mr. Chairman, it is my privilege to address your distinguished committee on the profound challenges that are facing agriculture and possible impacts of some of the tax policy proposals. First, let me reiterate that my assumed role as an educator is to assist in clarifying the problems, outlining alternatives, and discussing the probable consequences of policy options, so that citizens and their leaders have a broader appreciation of the facts for public decision-making.

Having said that, let me focus my remaining remarks into two areas: (1) the nature of the agricultural problems as they relate to tax policy and the present financial stress, and (2) the tax policy options available to government in the present situation.

### Short-Run Versus Long-Term

Very simply the short-run problem as perceived by many farmers is: "How do you stay in business another year?" The long-term problem as viewed by others is: "What should be the structure of agriculture and who should own the land?" Let's look at each in turn.

First there is no question that the rules of the economy have changed from the buy now-pay later inflationary 1970s to the pay-as-you-go 1980s with interest rates above the inflation rate. Second, the more than 40% rise in the exchange value of the dollar since 1980, has reduced our export potential and stimulated imports. As long as we are committed to fighting inflation, we are likely to see a much higher value of the dollar than was true for the 1970s.

As a result, agricultural producers cannot survive during the 1980s with debt levels that many incurred during the 1970s. While 70 to 80% debt was the debt lid of the 1970s, 50 to 60% debt may become the debt lid of the 1980s. A recent FARM JOURNAL survey showed that 1/3 of our nation's agricultural producers have debt-to-asset ratios over 40%.

With current levels for interest rates and grain prices, it is common to find producers with an adequate return before debt service and negative return after debt service. For the 1/3 of the nation's farmers that hold 2/3 of the farm debt, the short-term problem is to reduce their debt level in order to shift the return on debt over to the operator's earned net worth.

However, in spite of all management attempts to survive, in all likelyhood, we will see a dramatic increase in agricultural land tranfers through voluntary, involuntary, and foreclosure sales. The normal annual rate of land transfer during the 1970s was about 3 to 4% of the land base. The supply of land available for sale during the next 3 to 5 years might be more than double previous rates in some states. Collegues in the neighboring state of Iowa are talking even higher rates for their state. As a result, land values are likely to remain soft and a short-run policy problem has developed: "How much agricultural land should be available for sale at any one time and who should be allowed to purchase it?"

One concern that has philosophical roots in agricultural fundamentalism is the belief that land ought to be owned by those who till the soil. On the other hand, the contemporary view of market oriented philosophy is to sell land to the highest bidder, regardless of buyer occupation or residence.

Who will buy the land in 1985 and 1986? Low-debt farmers with cash are interested in buying land for future expansion as cheaply as possible. Bargain land and machinery prices may give rise to a new generation of entrants into agricultural production. Many successful farmers of the 1960s and 1970s were those who bought cheap land at the end of the Great Depression. In addition, a growing number of agricultural lenders and private investment firms are entertaining discussions on how to package agricultural land for national investment markets and nonfarm investors.

Should agricultural lenders who acquire land through foreclosure immediately sell that land to other farm and/or nonfarm investors or should they be given incentives to hold land off the market and lease it to farmers until the land market stabilizes? Should government allow a rapid decline in land prices to continue or should it step in and acquire foreclosed land to absorb part of the lender's asset loss and lease it back to foreclosed farmers with an option to buy?

In addition, one farm management option that has been considered by some high-debt producers is to lower their farm's debt service by taking on new partners with equity capital. Conceptually, this can be done through general partnerships, limited partnerships, and family corporations, as well as other nonfarm investor partnerships, corporations, or private sale-lease-back options. Under some circumstances, it must be said that this option can assist some producers in surviving their current farm finance situation.

These trends imply that changes in tax policy that would limit nonfarm investment would also tend to reduce the capital available for investment in high debt farms prior to foreclosure and for purchases in the land market. As a result, land values would tend to decline even more sharply in regions where significant nonfarm investment opportunities might otherwise exist.

In contrast, there are those who believe that our national tax policies give tax preferences to nonfarm investors and that our policies should foster moderate size, pastoral family farm ownership. Specifically, graduated tax rates coupled with investment credit, accelerated depreciation, and capital gains provisions give larger deductions to high tax-bracket nonfarm investors than to lower-bracket agricultural producers.

Senator, your research highlights the results of the current tax policy on the structure of agriculture. For example, fed cattle numbers have been on the rise in the feedlots of the Southern Plains. A significant number of these fed cattle are in custom feeding operations that cater to tax shelter investments. However, fed cattle numbers in the Upper Plains have been declining. Most of the cattle in this region are fed in moderate size owner-operated feedlots on diversified farms. While it is difficult to separate out the impacts due to regional resources available, economic efficiency, and regional demand differences, tax policy has been a factor in this operating environment.

Many in my profession attempt to debate whether tax policy is neutral or not. My point is that people usually define neutral as their present tax bill minus 10%. There never will be a "fair and equitable" tax system that is acceptable to everyone. Therefore the question is: What type of agriculture do we want and what tax rules would pass Congress and still head us in that direction?

Do we want dispersed land ownership among farm and nonfarm people? Should land be owned by those who farm it? Is it alright to have the land held by a few people or corporations? Does land ownership constitute control? Does the current financial stress in agriculture take precedence over our long-term land ownership objectives?

## Agriculture And Tax Policy Options

Option 1. Market oriented land market policy in combination with current tax policy. Market oriented land policy would allow survival of the fittest to take place.

Land prices might decline more sharply in the short run until debt levels are reduced to manageable levels for most producers and the supply of land for sale declines to "normal" levels. Agricultural lenders would absorb the decline in asset values on foreclosed land. Farm and nonfarm land buyers face lower land purchase prices.

If combined with current tax policy, however, the decline in land values is slowed by less restrictions on nonfarm investment compared to tax policy that limits nonfarm investment. Additional nonfarm investment agriculture might occur as sale-lease-back-options develop under private initiative and as lenders attempt to move foreclosed land on to the market and off their books.

Option 2. Market oriented land policy and tax policy that limits nonfarm investment. This option would have similar results to Option 1, except that the limits on nonfarm investment in agriculture might tend to create a deeper decline in land values in the short run.

Option 3. Government acquires foreclosed land of private lenders in an attempt to stabilize the land market. Government absorbs part of the lender risk resulting from declining asset values. The government acquired land could be taken out of production or leased back to foreclosed farmers to give them an opportunity to start over under the current rules of the economy. Foreclosed farmers could also be given first option to buy their land back at some specified time in the future.

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A government land support and/or lease back program would tend to offset the land market impacts of a change in tax policy that limits nonfarm investment in agriculture. In addition, land would be held for future purchase by farm rather than nonfarm investors.

Option 4. A government program to buy down farm debt might accomplish many of the aspects of Option 3. The major difference is that less foreclosures occur and titles do not transfer from farmers to the government. This option would also tend to offset possible impacts of a change in tax policy that limits nonfarm investment ~~in agriculture~~ because the short-run demand for nonfarm investment would be reduced.

In the final analysis, tax policy is one factor that affects the structure of agriculture. Many of the tax preferences used by nonfarm investors might be eliminated if we changed our tax policy to flatter rates, and eliminated accelerated depreciation, capital gains and investment credit tax preferences. And if we really want to preserve moderate size, pastoral family farm agriculture, additional policy changes could give economic preferences to these farms once we have defined them.

Also, I have not mentioned a word about costs to the Treasury for the various options. For some of the options, significant costs are involved. With a $215 billion farm debt, for example, a 20% farm debt buy-down program for the 1/3 most financially stressed producers (that hold 2/3 of the farm debt) would cost about $30 billion. A large government land purchase program could cost more. Congress would quickly face a "Guns versus Butter" choice once again.

Finally, in a recent 17-state survey of farm policy attitudes of farmers, the message on the budget deficit came through loud and clear. According to 72 to 87% of the producers in all of the states, balancing the budget is a worthy objective. Furthermore, 55 to 72% of producer respondents in all the states agree to across the board expenditure cuts, even if it means cuts in farm program expenditures. However, a plurality of 27 to 48% in the states generally disagree with proposals to freeze expenditures and raise taxes. This implies that expenditure cuts--and only raising taxes as a last resort--is the generally preferred approach.

In closing, I certainly want to commend you Senator for your attempt to gain greater visability for the the impact of tax policy on agriculture. I wish you best success in taking the message to Washington.

Senator ABDNOR. Thank you. Tell me, what was that poll runout of?

Mr. EDELMAN. It was coordinated by the University of Illinois and Purdue University, my colleagues, agriculture economists there. We participated in that survey. We conducted the portion of the survey that occurred in South Dakota. We had a random sampling of 1,500 producers across the State randomly selected on what their attitudes were on 1985 farm policy options.

Senator ABDNOR. That was all farmers, all 1,500 who participated were farmers on the——

Mr. EDELMAN. That was South Dakota's portion. In total there's about 8,000 farmers that were surveyed in these 17 States that participated in the national effort. I'd be more than happy to provide you additional copies of the results of that survey.

Senator ABDNOR. That would be excellent. Fifteen hundred, I'm not a pollster, but I know that's an awfully high number and the more you have, the more accurate it is.

Mr. EDELMAN. We sent it to 1,500. The response rate was 32 percent, about 480 for South Dakota.

Senator ABDNOR. Let me ask you, also, in talking about the future in land sales and all, do you really think there's any way we can control who could buy land? I mean is there anything Congress or anyone could do to say which one of these three categories might be buying land or control it? That would be a pretty hard thing, wouldn't it?

Mr. EDELMAN. Well, yes, that would. However, your tax policy that you establish and how you treat capital gains influences nonfarm investment and farm investment in farmland. So you do create the environment through your tax policy that you do pass.

Senator ABDNOR. That's really an excellent point you bring out there. That really comes back to why we're holding these hearings on taxes and farming. In my mind from what I've seen of this, this really has done much to drive up the price of land and make it so extremely high for farmers to try to buy and sell, because there's outside people who can capitalize on the tax situation and afford to pay more for it than a bona fide farmer.

Mr. EDELMAN. The point I'm trying to make in the current situation, though, is that if a large amount of land comes on the market this spring because of involuntary, voluntary or foreclosure sales, if at the same time you were to place limits on nonfarm investment in agriculture or reduce incentives for nonfarm investment, that nonfarm investment would tend to reduce in agriculture, that you might have a sharper decline in land values than you otherwise would have. So the timing of those kinds of changes in the current economic environment has to be looked at pretty closely.

Senator ABDNOR. I might mention that I had gone into this somewhat in Washington at a hearing, and Mr. Harle was one of the leading economists, he pointed out if you come into it too rapidly, it could cause some problems, too. It would have some effect.

Mr. EDELMAN. It would have a larger impact in those areas across the country that particularly have a large amount of nonfarm investment, and at this point I have no comments on how South Dakota would stack up relative to other States in that regard.

Senator ABDNOR. Very good. Thank you. Mr. Charles Johnson, could you come forward? We thank you for coming out. We know you've been awfully busy in your farm activities.

## STATEMENT OF CHARLES JOHNSON, FAMILY FARMER, MADISON, SD, ON BEHALF OF THE SOUTH DAKOTA NATIONAL FARMERS ORGANIZATION

Mr. JOHNSON. Been out to Pierre yesterday. Thank you, Senator. Substituting for our State president, Ken Eckman, he asked me to substitute for him. He was busy the last few weeks for Farmers Union and American Agriculture putting on the rally in Pierre. I've been busy myself organizing activities in Lake County and had a late drive from Pierre and did chores, got up this morning, did chores and came here. I enjoy the chance.

My name is Charles Johnson. I'm from Madison, SD. I'm a family farmer there. I farm with my younger brother and farm 720 acres, mostly hogs, farrow to finish and some cash crops. Also am a full member and a member of the South Dakota Farmers Union. For some years I've worked closely with the Center for Rural Affairs from Walthill, NE, their nonmember organization in tax policy and farm policy, and for a couple of those years I worked with one of their staff members, Chuck Hassebrook, on an educational effort in two States, Minnesota and South Dakota, while he worked in Nebraska and Iowa on educating farm groups and commodity groups on the effect of tax policy on agriculture. It was quite an educational effort. I had quite a bit of demands on the farm to run my farm, so it wasn't as extensive an effort here in South Dakota and Minnesota as he did in Iowa and Nebraska, but through the efforts, what they've done, I think we made some headway in bringing the issue out to the open, not that we've come to any answer, but bringing an issue out as an important one. Some reasons in the concern for tax law policy, Harold Breimyer, a noted economist from this area, has stated if we do not change tax policy to benefit the family farmer, that if we do not do so within the 1980's, that we will not have family farms here in the 1990's. That's the premise of his belief.

Senator ABDNOR. If I could interrupt you, on two occasions I've had Mr. Breimyer in front of our committee because I, too, think very highly of this man. We've moved hard in the Joint Economic Committee in getting these great economists that didn't know anything about agriculture. We made a change and brought some agriculture economists, and he and Mr. Schuh of Minnesota were very helpful to us.

Mr. JOHNSON. He's very good and very knowledgeable. One premise, too, is that in agriculture, that a 1-percent increase in production causes roughly a 2-percent drop in price. We need to keep that in mind as tax law affects overproduction and oversupply in agriculture. Some other bad effects, it brings about absentee ownership, corporate farm, custom feeding. It creates unfair competition for the working family farmer, and it makes economic decisions to become based on the Tax Code rather than on efficiency and profit. It further increases the Federal deficit which we all must suffer from.

Some things I want to explain on tax shelter abuse, some examples, there are many farms in South Dakota that are depreciated out, even though they are not useful or lived in. Abandoned farms that are bought by investors for their capital gains effect of depreciation on the buildings, even though those buildings are not being used. I think that's unfair to the working farmer and also to society when we allow these buildings that are not being used to be written off through the Tax Code. Also, it creates huge increases in land and equipment prices through interest deductions, and I think it was brought out earlier that it pushes young and highly leverage young farmers into troublesome debts when they try to compete with investors to buy their first piece of land or equipment.

I think that has all come back to haunt us now. We have farmers that are unable to service the high debts they incurred in late 1975 to compete with investors and high income individuals to get into farming. You mentioned the IRS survey. I saw a clipping a couple weeks ago in the paper referring to that same survey in 1982, that of all the returns that made more than $200,000 that filed schedule F's, 80 percent of those returns showed a loss. The average loss was $65,000. So we don't need to have that kind of thing occurring both in farming and in the Federal Treasury.

We all know livestock feeding is suffering from tax shelter. Cattle feeding is rapidly moving to the South and West and is leaving the upper Midwest. We have numerous feedlots in Lake County that are sitting empty today, mainly because they cannot compete with operators who design their operations to lose money rather than to make money. Hog feeding is fastly going to corporate entities and custom feeding. Dairy farming is also moving to the South and West. Huge herds of hundreds and thousands of cows are being owned and operated by absentee owners. I guess the question I ask, is it really efficient for cattle production or any type of commodity production when you move the feed and the grain South and West, feed it there and bring the finished product back when it could be done just as efficiently and more useful here in the upper Midwest.

Also, cheap food which tax shelters help contribute to actually cost society a lot. We all talk about cheap food, but there are some hidden costs to that cheap food. Tax policy is a hidden cost in our cheap food policy. It does contribute to our cost of food. It creates deficits in the Federal revenue, and it creates unemployed farmers which then again strains the social safety net programs that our country has designed. It doesn't allow working farmers the ability to pay local, State, and Federal taxes when you create an unfair economic competition situation. When they are going broke or can't pay their bills, sales tax revenues go down, property taxes aren't able to be paid and, of course, no income tax is paid into the Federal Treasury. We must remember that farming is a biological system, not an industrial system. Yet when we apply a tax policy that is industrial in nature, we create a conflict. With tax policy we are prioritizing machinery and hardware over people and land, and that is not a very good situation to have.

Just a few comments I've got on S. 224. I think it's an excellent move to keep tax sheltering out of agriculture by high-income individuals. So I highly support that. Yet it allows young, beginning farmers to get into farming by still working in town, that you're allowing a certain level, medium income where the wife or husband can work in town and still use the income off the farm to apply toward the farming operation as they get started. One concern I do have, though, on S. 224, it does not have any limits on high-income farmers who could still use the Tax Code for their own benefit. We must remember the Tax Code is abused just as much by the high-income farmers as it is by the gentleman farmer or absentee owner.

Senator ABDNOR. Like how? You mean going out and investing it in tax losses somewhere else?

Mr. JOHNSON. What I'm suggesting is land that comes up for sale. You have a young farmer who wants to get into farming, yet there is a large landowner in the area, large farmer, high-income farmer, and the Tax Code is going to subsidize or help that high-income farmer to buy that piece of land if it comes up for sale. Who loses out is the young farmer. That means we have one less young farmer getting started in a consolidation of the land by the few wealthy ones.

Senator ABDNOR. Do you have any thought as to how we might do that? Sometimes that's a problem. You have to stay within the Constitution. I was wondering if you carried it through as to how you would propose that.

Mr. JOHNSON. Eventually along the lines, Senator, even though with this bill we'll hopefully try to keep high-income investors out of agriculture with this bill, we need to look at specific measures like investment credit and capital gains and cash accounting and either do away with those types of measures entirely or get them construed so they'll help the working family farmer. So that's my premise there.

Just to summarize a little bit, I want to mention some involvement by farm and church groups in tax policy. NFO does have a strong resolution and policy statement on the need for Federal tax reform on a national level. It's in their policy statement, and their Washington office which is headed by Chuck Frasier is an excellent office and I'm sure will work real closely with you, Senator, on this bill. Farmers Union is also involved in this tax policy area and it supports reform. Catholic Rural Life is also supportive and the upper Midwest area, in North Dakota, South Dakota, Minnesota, they have adopted a strong policy statement on tax policy reform. We all know the REA's are aware of tax policy. They know, they have competed against private utilities that use harbor utilities type of measures. Yesterday as you read your program at the rally, the Farm Alliance wanted the five major goals they have is reform on Federal tax policy, and if I could briefly read it. Reform on Federal Tax Code is needed to eliminate loopholes and tax shelters that have allowed nonfarm investors an unfair advantage compared to bona fide family ranchers. In the event a complete tax reform is not accomplished this year, we support Senator Abdnor's bill to place definite limits on farm and ranch losses that could be used to reduce tax liability on nonfarm income.

Last, I want to mention that I do go to coffee shops quite a bit. I visit with farmers my age and other farmers, and more and more the issue and a discussion of tax policy comes up. They're not talking just about loans and prices. They're worried and concerned about people they have to compete with, and tax policy is coming up quite a bit in coffee shop talk. I consider it personally one of three big issues in agriculture. Credit, prices, and taxes. It's one of the big three and we need to place it on that level. So Senator, I appreciate your work on this effort and commend you and wish you the best as you push S. 224 through.

Senator ABDNOR. Thank you. I really appreciate that. Let me ask you, Mr. Johnson, I know you're a busy fellow, but have you had a chance to spend any time looking over the new tax proposals? There's three of them floating around Congress. One is called the Bradley-Gephardt bill, one is Kemp-Kasten bill, and one is the Treasury bill. There are a lot of similarities and some differences. Going in that direction do you think these have some merit?

Mr. JOHNSON. I think in general if you can work toward a tax policy that reduces the deductions or eliminates them, yet lowers the tax rate is a move in the right direction in a general sense. I haven't studied the three measures in detail, but I do have a worksheet at home.

Senator ABDNOR. We'd be happy to hear from you when you come to some conclusions. That's also of great interest to us. As I said, I don't think the passage of it is very likely in the first year of the Congress. I also have said I think the economy of Washington, DC, will go up considerably, and the hotel rooms and restaurants, I'm sure, will bring in every group of the United States when we start looking at these exclusions people are receiving. They'll spare no word or distance to come. If you come in during those times, you better make reservations well in advance. Really, there will be a lot of testimony and days and days of hearings. Members of Congress, on both political sides of leadership through the House and Senate, I think, feel the deficits have to be looked at and take top priority at this time. It doesn't mean Mr. Baker, the new Secretary of the Treasury, has said that tax reforms should have a place alongside of it. I am sure it will. It's going to take longer than looking over the tax deficit situation. I would now like to call my next witness, Richard Negstad, chairman of the South Dakota County Commissioners Association. Mr. Negstad is also a county commissioner and a farm and tax accountant. He'll be interesting to hear from. Mr. Negstad, we appreciate your coming here. I appreciate testimony from someone like yourself who sees what the revenue collections mean to Government and who sees the local level of property taxes. Please proceed in any manner you wish.

## STATEMENT OF RICHARD NEGSTAD, CHAIRMAN, SOUTH DAKOTA COUNTY COMMISSIONERS ASSOCIATION

Mr. NEGSTAD. Thank you, Senator Abdnor. I do believe that taxation of farm economy is important to us in all aspects. It's important to me as a farmer. It's important to local elected officials like county commissioners. However, what I'm going to say today, I should point out is my personal opinion. I'm not really representing county commissioners on this.

I think we do need tax reform. I think we do need it for two main reasons, the way I see it, some of which have already been mentioned. Basically one of the main reasons we need it is the unfairness of the present Tax Code in my opinion. We do have too many loopholes. Some of these loopholes were put in perhaps for a good reason at the time. I looked up a tax form 1040 for 1960, for example, just to look at what the tax rates were at one time. In 1960, the top tax rate was 91 percent. It shows here right in the table, the top rate was 91 percent on income tax. Well, I think at that time it was necessary for some loopholes basically to be put in. It is unfair for anyone to pay 91 percent of their income in tax, I believe, regardless of how wealthy you are. That's when some of these things like capital gains were put in.

Senator ABDNOR. That's a good point. That's a fact.

Mr. NEGSTAD. Over the years, the upper level of the tax rate has decreased. I can't remember all the steps. I think it probably went to 77 percent, then 70 percent, now it's 50 percent. With some of these major reform proposals, the top rate might drop to 35 percent. Even now at 50 percent, I don't feel that capital gain deduction is necessary anymore. If it went even lower, there would be even less need for it. As it was pointed out, you know, farmers do benefit from some of these things. I do benefit in some ways from capital gains and from fast depreciation and from investment credit, that is, when I'm making money, anyway, which isn't every year. I think in the long run they have hurt farmers. They have hurt the small- and medium-sized farmer, because it has allowed outside investors, outside people with money to come in and buy, for example, a hog finishing unit. Right now they can come in and buy a hog finishing unit, use the fast depreciation, turn around and sell it and pay income tax at the capital gains rate on that income.

Senator ABDNOR. That's true. Under this new tax proposal of the Treasury, and I think some of the other ones, they do away with the capital gain. The Treasury would index the inflationary costs. It's not fair, I guess, to pay regular tax on something that really isn't worth anymore than the day you bought it, only because of the inflation as the price got up. That feature would be in this proposal of the Treasury, the indexing they would do away with would be the capital gain itself.

Mr. NEGSTAD. The indexing part would be fair. With this capital gain, the way it presently is, why should somebody that's working with the sweat of your brow, you might say, earning money maybe at a higher rate than somebody just buying and selling stock paying capital gain? It doesn't make sense. I think generally speaking with our whole income code, I brought this year's form deal along, it shows you how many things we're deducting. We've made it too complex. Many of them benefit us individually, but I think we would be much further ahead if we threw out a lot of them and paid a simple rate. We have an adjustment to income. These are things you subtract. Moving expenses, employee business expenses, IRA deductions, Keogh, penalty on early withdrawal of savings, alimony, deduction for married couple who both work. Each one of them probably sounds fine. Overall they create a complicated Tax Code that doesn't serve the purpose intended. On the credit side, we have credit for child and dependent care expense, credit for elderly and permanently and totally disabled, residential energy credit, partial credit for political contributions, general business credit, foreign tax credit. We've gone too far in my opinion. We kind of need to throw out the whole thing and start over, which I think the major reform proposals do.

Another basic issue with our general income tax situation, I think, is that people are getting the opinion now that something is wrong with it, that it is unfair. There are too many loopholes that the rich people are getting without paying, so why should I be honest and pay? This would be a major disadvantage to our whole system. If the average person decides it is unfair and, therefore, it's OK to cheat, the whole system will be in trouble. To me that's another reason for simplifying it. I think your bill, S. 244 that would limit the losses would be a good step, the farm losses that they could deduct against other things. I think that's a good step for now, but I guess I hope that we can go on and reform the whole thing. If we did, perhaps we wouldn't need that again.

Senator ABDNOR. That's true. That's a good point.

Mr. NEGSTAD. The other major reason I think we need tax reform is just the general complexity of it. Again, if you—this is the 1984 booklet and this is the 1960's, 24 years difference. If you look at the thickness of them, the size of them, you can see how much complexity we have gotten into. I have been doing some tax preparation for 15 years now, and it's gotten so complex, even the preparers are having difficulty keeping up with it. I don't think it should be that way. The average person should be able to do his own tax. Maybe I'd lose business that way, fine. I think it's a fundamental right of the people to understand the income tax well enough so most people could do it themself. One of the things they do, they save the tax preparer's fee, but on the other hand, if they understand it themselves and do it themselves, they can use the Tax Code to their advantage better. In other words, now when they don't understand it, they don't understand the ramifications of a trade this year versus next year, for example, how long does investment credit last? What about this accelerated depreciation if I trade this year? It's gotten way too complicated. The new things that just affect the tax preparer this year, the book, the publication that just talked about the changes is a regular book. Just the dates, the new changes went into effect covered a whole chapter because the changes went into effect every different day of the year practically. So to me that's another reason for tax reform.

Basically if we do have tax reform, I think there should be two main things we want out of it. It should do two things in my opinion. One is to close the loopholes and credits, whatever, that we have in it now. Again, farmers would temporarily be at a disadvantage sometime. Some of these credits and loopholes, fast depreciation to help farmers. I think in the long run the small and medium family farmer would be much better off. I think, Senator, you mentioned, for example, the money lost now. There was a little word in the Argus Leader yesterday. I don't always agree with what Ralph Nader comes up with, but in this case the study shows the Federal Government lost $24 billion last year in tax shelters with 82 percent of the money going to people with annual incomes of more than $100,000. Assuming that's accurate, I think that's too bad.

Senator ABDNOR. Do you think a tax loss should be written specifically? Say we wouldn't need my type of a proposal in the new tax reform, is there any way you could conceivably have the flat tax and might still be eligible? It's a little different than capital gain. It's a loss. It shows on the business operation.

Mr. NEGSTAD. You might still need it. I guess the chances would be much less, because people with outside money wouldn't be getting into the farm enterprise as a tax loss enterprise. In other words, if you didn't have the investment credit, accelerated depreciation, capital gains, there really wouldn't be an incentive for them to get in that. That's what's pointed out I think by Mr. Edelman. Conceivably, of course, if you change this all at once, you might drive land prices down further yet, too. That is another thing to consider as to putting this in. Right now with the farm economy so depressed, it might not be a good time. It would take some time and it could get done at best, anyway.

Senator ABDNOR. Thank you very much.

Mr. NEGSTAD. One other point on the tax reform thing. This is strictly opinion. With the Federal deficit the way we have it, if we get tax reform, it should be done where we raise additional money. I think from a farmer's standpoint, if we could get the Federal deficit down so it would look like it was going to get back to zero in a few years at least, it would lower interest rates and weaken the dollar some. Again, I'm not an economist, but I think that would do it. If you lowered interest rates, that would definitely help the farm economy. If you would weaken the dollar a little so we could sell more stuff abroad, it would help prices some. It would definitely help farmers. I feel you should raise some additional money in the tax reform.

Senator ABDNOR. I would almost say that is not going to happen, but it could happen once we make our cuts in the deficit. A lot of Members of Congress want to make sure if taxes get raised, it's used to retire debt, not to spend more money. The large sizable tax interest was TEFRA, Tax Equity and Final Responsibility Act. The general agreement to get the President to go along with it, that they were going to cut spending $3 for every $1 we increased taxes. The end result would be an increased spending of $3 or more for every dollar we were spending. This time they're a little more eager to see it really happening. Upfront you're saying you're not going to have new tax increases, but I think it could happen once they get this budget settled and decide where the cuts are going to be so the dollars that would come in would truely go to cut down the deficit. I agree with you that that's the quickest way I know to get interest rates down and to get the dollar back in line.

Mr. NEGSTAD. If I may point out one thing, this is energy assistance for the elderly, out of the Minneapolis Tribune on last Saturday. In Minneapolis basically they're trying to find more people to give away low-income energy assistance money. The low-income energy assistance money is a worthwhile program, but if it gets to the point where people aren't applying for it, how far do we go? For 4 months the Minneapolis energy assistance program has been trying to find the estimated 32,000 low-income households that are eligible for this assistance. How hard should we try to find them?

Senator ABDNOR. I should carry that with me because we get criticized so many times on that. I can assure you in the round of cuts, it's not going to be any reduction on the poverty end. There are those who would have you believe we have totally neglected this group of people. I don't think figures always back that up.

Mr. NEGSTAD. I think we need to get to a point we help those that need it, but we have to look more at the actual need before we hand out the money.

Senator ABDNOR. Thank you. Our next witness is Ron Durst. He's a tax specialist from the U.S. Department of Agriculture. Ron, you're right out of the Department of Agriculture in Washington, right?

Mr. DURST. Yes, I work with the Economic Research Service.

Senator ABDNOR. We appreciate you coming all the way out here. Maybe we can learn something on how farmers would be directly affected by this new flat tax or tax simplification. I'd like to hear your views on the bill that I have introduced. Thank you.

## STATEMENT OF RON DURST, LEADER, TAX POLICY PROJECT, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. DURST. Mr. Chairman, I appreciate the opportunity to participate in this hearing on taxes and agriculture. I am Ron Durst, leader of the tax policy project at Economic Research Service from the U.S. Department of Agriculture. Before I get into it, my general remarks, I'd like to say that I spent my first 20 years of my life on a small dairy farm, so I haven't spent my entire life inside the beltway in Washington.

Over the years, Congress has enacted and modified various tax provisions to achieve desired social and economic goals, such as stimulating investment, conserving soil or water resources, increasing the efficiency of use of scarce input such as energy, and preserving a desired structure of business and property ownership. These laws and regulations provide special tax treatment for a variety of business activities. Many of these activities are unique to a particular industry or group of industries. Agriculture in most other industries benefit from a variety of these tax provisions. It is not clear whether agriculture benefits more or less than other sectors in the economy or the relative importance of tax policy versus commodity, credit, and other government policies is uncertain. However, it is clear tax policies have played a role in the changes that have occurred within the sector and they will continue to affect the organization, allocation, and control of farm resources in the future.

The provisions of primary importance to agriculture include the use of the cash method of accounting, the immediate deduction of certain capital costs, capital gains treatment for income from assets which may have been expensed, the tax treatment of land investments, the capital cost recovery system, including depreciation and investment tax credit, and the corporate income tax, particularly the graduating tax rate schedules. These provisions generally create benefits for those who can qualify for them and hence they create incentives for firms and individuals to modify their operations to qualify for these special tax provisions.

I think how one views these tax provisions and their affects on economic behavior depends largely on one's position in the market, whether it is the farmer whose product prices are being depressed by the overstimulated supply, a young would-be farmer facing asset values that face potential tax shelter returns to high income individuals, an investor looking for a tax shelter, a supplier of capital inputs to farmer, or a handler, processor or a consumer of farm products who may benefit from the increased supply of farm products. Providing information to assist the administration and the Congress in making policy decisions is one of the major roles of the Economic Research Service. As part of our regular program of research and analysis, we conduct research on the impact of taxes and tax policies on farms and food and fiber system.

In recent years USDA and various other organizations have conducted research examining the impact of tax laws on the agricultural community. Some of the most significant conclusions of this research are, first, the tax laws have encouraged the growth and expansion of existing farm businesses. Second, favorable tax provisions have stimulated tax motivated investments in the sector, distorting relative input and commodity prices. Third, various tax provisions have encouraged farmers to alter management practices affecting the patterns and timing of input purchases and crop and livestock sales. Fourth, during times of inflation, various tax provisions have encouraged farmers to increase their use of debt capital to expand. Fifth, tax laws have encouraged a large number of family farms to alter the organizational structure of their farm business, and, finally, that tax incentives for capital investment combined with increased taxes on labor have accelerated the substitution of capital for labor in the agricultural sector.

I think despite the substantial amount of attention that taxes and tax policy on agriculture has received in recent years, a number of questions remain unanswered, particularly as to the magnitude of the effects. I think even more questions are likely to arise in the near future as the interest in tax reform grows. Some of the questions certain to be asked, include, How would agriculture be affected under a modified flat tax system in which marginal tax rates were reduced and many of the deductions and credits would be eliminated? Would the organization, allocation, and control of resources in the sector be altered? If so, in what manner and to what extent? Would these changes be consistent with existing commodity credit and other Government policy goals? Also, how would tax reform in the income tax area affect the Social Security tax liabilities for many farmers and small businesses? This is an issue I haven't heard addressed much, but it is very important. Policymakers are likely to face these and similar questions in the near future. Therefore, during our discussion here today, I hope we can focus not only on the issues raised by our current progressive tax rate system, but also those questions associated with our general tax reform and its effect on the agricultural sector. I know I've raised probably more questions and not really answered anything, but I would like probably most of that to come from the discussion. Again, I'd like to thank you for letting me participate.

Senator ABDNOR. We thank you for coming all the way out from Washington. You are probably the most factual and knowledgeable individual we have here. I'm sure you followed that Treasury tax proposal to some degree, and knowing what you do about our present problems and the Tax Code, would you say just offhand that this looks like it would be an overall improvement or advantage to the farmers?

Mr. DURST. I think the Treasury's proposal has a lot of things to offer in terms of eliminating many of the distortions we have now because of our tax system. One of the main goals of Treasury's proposal is to neutralize many of the distortions, and I think that's probably emphasized over many of the other, even over simplicity and even maybe over the equity. I think in terms of neutralizing the effect of the tax system on investment and other decisions is probably one of the major achievements of that package, particularly because of the lowering of the marginal tax rates, and also by indexing various portions of the depreciation deduction and capital gains and the manner in which the interest income and interest expenses are addressed, eliminate the incentives to incur debt and to invest in capital assets to get those accelerated deductions upfront. So there are a lot of things that the Treasury proposal I think offers in terms of neutralizing many of these distortions we see in agriculture.

Senator ABDNOR. Then let me ask you this. Those are probably some of the advantages of it. What would you see that would be a disadvantage or that has been beneficial to agriculture that we would be dropping in this tax proposal? Are there things like an investment credit, how do you think that would affect agriculture?

Mr. DURST. Investment credit is really important, particularly to a low-income individual. By Treasury's proposal by indexing depreciation deductions, what you're doing is you're not allowing a lot up front, but since those deductions are going to be indexed over the years, you'll eventually in some cases get in much in terms of the present value in writeoff as under a situation where you have a tax credit and a depreciation deduction. It all depends on the inflation rate. Under high inflation scenarios, Treasury's, I guess its real cost recovery system, would be as favorable as RCRS. Our current depreciation and tax credits are greatly affected by inflation, and right now with low inflation rates, the benefits provided by RCRS are pretty substantial.

Senator ABDNOR. Even though there may be some disadvantages in the bill, the overall gives you a higher exemption for families and dependents and lower rates. This sort of thing all has to be weighed in the whole package to measure the real advantages and disadvantages to it.

Mr. DURST. Right. I think the Treasury's proposal is just that at this point, is a proposal and it hasn't been put forth in legislative form, and obviously there's going to be some discussion and probably some combination of some of the other bills. According to Treasury's estimates, some of the, particularly the lower-income brackets will receive substantial reductions in their average and marginal tax rates, and I think overall they estimate 78 percent of individuals will either pay the same or a lower amount in taxes under the plan.

Senator ABDNOR. Thank you again, Mr. Durst.

Mr. DURST. I have one other thing. One issue I'd like to bring up. I don't think it's been raised much and it's something that needs to be discussed. In tax reform, when we start addressing the income tax area, if we go to expanding the tax base, one thing that our Social Security tax liability is based on is our income tax base, net farm profit. Even though our expansion into tax base may be offset by the reduced rates in terms of the income tax area, self-employed farmers, self-employed businessmen are going to face higher self-employment taxes because of the expanded tax base, and that's just an issue I think that in this whole debate about tax reform needs to be kept in line.

Senator ABDNOR. I hope we have some testimony that will bring out some questions and answers here as we go along. I'll be able to call you again.

Is Marie Fisher here? I guess not. Marie is from Winner with Women Involved in Farm Economics, she's from Tripp County. Luverne Jensen? I wonder if we have a substitute for Luverne. He's president of the American Agriculture Movement. Is anyone representing that group? Gayle Kocer from Martin, she's with the South Dakota Wheat Producers. Anyone from the South Dakota Wheat Producers here? Well, now I will call William Daniel from the South Dakota Livestock Association. Mr. Daniel.

Mr. DANIEL. I'm here, but we're not prepared to testify.

Senator ABDNOR. You will be submitting a statement for the record?

Mr. DANIEL. No.

Senator ABDNOR. Let me ask this. Did anyone else come prepared to testify? Father Kayser, Father Leonard Kayser, director of the Catholic Rural Life Conference. He did a fine job yesterday. I didn't know whether he made it down here or not, but we appreciate the effort you're making. Please proceed.

## STATEMENT OF FATHER LEONARD KAYSER, DIRECTOR, CATHOLIC RURAL LIFE CONFERENCE, ESTELLINE, SD

Father KAYSER. Thank you for the opportunity to advise you and your staff regarding our Federal tax system. I want to return the tremendous appreciation I have for the powerful statement you delivered yesterday to our people in Pierre. It was tremendous. I've been active in the Catholic Rural Life Conference for some years, as you know, Senator. In the process of the bishops of the heartland developing their land ownership and stewardship statements, strangers and guests in 1980, we came to realize that one of the major policy issues affecting what we consider to be equitable and just land ownership and land stewardship is God's gift is the issue of tax policy. We consider this to be one of the major elements in the critical question that we're facing in this rural crisis; namely, land tenure in the United States and the injustices as we see them toward the family farm system. As former secretary, Bob Bergland said, agriculture is the flagship of the American economy, then it's certainly in the best interests of all segments of the American economy that agriculture provide its fair share of the taxes which provide us with necessary services. It's also necessary that agriculture not be asked to carry more than its share or be penalized and castrated of its potential for sustainability and as the base for the rest of the economy. I'll only take a moment of your time this morning and submit the extensive policy statement of our National

Catholic Rural Life Conference with commentary on each of the various segments of the tax policy of our country. At this time I would like, however, to take a bit of time to share two portions of the Old Testament scriptures which I think might help us put this whole thing in a context of God's perspective, of his people on the land and how civil authorities can make that difficult, if not impossible.

The first section I would like to share is from the First Book of Samuel. The people are arguing with Samuel saying they want a king, and the Lord instructs Samuel as you know, to say:

> Listen to them, but give them strict warnings and explain how their Kings will treat them. Samuel told the people who were asking them for a king everything the Lord had said to him. This is how your king will treat you. He will make soldiers of your sons. Some of them will serve in his war, in his war chariots, others in his cavalry and others will run before his chariots. He will make some of them officers in charge of 1,000 men and others in charge of 50 men. Your sons will have to plow his fields, harvest his crops, and make his weapons and the equipment for his chariots. Your daughters will have to make perfumes for him and work as his cooks and bakers. He will take your best fields, vinyards, and olive groves and give them to his officials. He will take a tenth of your grain and of your grapes for his Court officers and other officials. He will take your servants and your best cattle and donkeys and make them work for him. He will take a tenth of your flocks and you, yourselves, will become his slaves. When that time comes, you will complain bitterly of your king whom you yourself chose but the Lord will not listen to your complaints.

The other passage I'd like to share is from the 47th chapter of Genesis at the time of the famine and the behavior of the supposed very philanthropic Joseph:

> The famine was so severe that the people, that there was no food anywhere, and the people of Egypt and Canaan became weak with hunger. As they brought grain, Joseph collected all the money and took it to the palace. When all the money in Egypt and Canaan was spent, the Egyptians came to Joseph and said, give us food. Don't let us die. Do something. Our money is all gone. Joseph answered, bring your livestock. I will give you food in exchange for it if your money is all gone. So they brought their livestock to Joseph and he gave them food in exchange for their horses, sheep, cattle, goats, and donkeys. That year he supplied them with food in exchange for all their livestock. The following year they came to him and said we will not hide the fact from you, sir, that our money is all gone and our livestock belongs to you. There's nothing left to give you except our bodies and our lands. Don't let us die. Do something. Don't let our fields be deserted. Buy us and our land in exchange for food. We will be the King's slaves. He will own our land. Give us grain to keep us alive and seeds so we can plant our fields. Joseph bought all the land in Egypt for the king. Every Egyptian was forced to sell his land because the famine was so severe, and all the land became the King's property. Joseph made slaves of the people from one end of Egypt to the other. The only land he did not buy was the land that belonged to the priests. They did not have to sell their lands because the king gave them an allowance to live on. Joseph said to the people, you see, I have now bought you and your lands for the king. Here is seed for you to sew in your fields. At the time of harvest you must give one fifth to the king. You can use the rest for seed and for food for yourselves and families.

There are other verses that are relevant but repetitious. I say that particularly because of the position of the church in these times and the challenge I have been given to myself and other people like me in that context. As I said in this statement here, I rather think we have found that the tax policy affecting agriculture really is a major thing in the whole thing of land tenure and the history there I think will bear it out. So I thank you for your time.

[The prepared statement of Father Kayser follows:]

## PREPARED STATEMENT OF FATHER LEONARD KAYSER

SEEKING JUST TAX POLICIES IN AGRICULTURE

(Policy statement of the National Catholic Rural Life Conference)
(Contact: Rev. Leonard Kayser: Estelline, SD 57234 605/873-2254)

The raising of revenue is one aspect of the fiscal role of government - the other side is appropriations or the manner in which government spends the revenue that has been raised. This paper deals with the revenue raising aspect and some of its provisions which affect profoundly the food production industry and the questions of who will own and control the agricultural resources of the United States.

In discussing revenue resources of government, we will first reflect on some basic themes dealing with the role of government as articulated by the Church in social teaching over the past 100 years. Secondly, we will apply these themes to five basic principles of justice, in taxation. Third, we will outline agricultural concerns caused by current tax policy which violate these principles. Fourth we will make specific recommendations designed to improve the implementation of the principles within the tax structure.

The Church regularly reflects on the scriptures and tradition, and applies to the current setting, these teachings concerning the moral and ethical practices of societies. Papal writings of the past century form a prophetic call to action for justice and also offer guidelines for moral decision making in economic and political life. From the Encyclical of Leo XIII, Rerum Novarum to the Encyclical of John Paul II, Laborem Exercens a hundred years of teachings have developed important themes upholding the value and dignity of the human individual within the context of the economic order. A brief outline of four such themes follows:

### THEMES

The government is to promote the COMMON GOOD defined as "the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment" (Vatican II Church in the Modern World No. 26). Individual human beings are social in nature. The welfare of individuals is the ultimate goal of all government activity. Government and private groups have complimentary roles and should cooperate in promoting the common good. Government should increase the effective freedom of individuals. If goverment is to serve the common good it must have the resources to do so and citizens have a responsibility to contribute to the public resources according to their ability to pay. "The best way to fulfill one's obligation of justice and love is to contribute to the common good according to one's means and the needs of others - even to the point of fostering and helping public and private organizations devoted to bettering the conditions of life....let everyone consider it their sacred duty to count social obligations among each individuals chief duties today and observe them as such." (Church in the Modern World No. 30.) In the

Encyclical Mater et Magistra, Pope John XXIII explains how economic prosperity is to be evaluated. "The system whereby both the common prosperity is achieved and individuals exercise their right to use material goods conforms fully to the norms laid down by the Creator. For thus it follows that the economic prosperity of any people is to be assessed, not so much from the sum total of goods and wealth possessed, as from the distribution of goods according to norms of justice, so that everyone in the community can develop and perfect himself." (No. 74.)

The second theme subsidiarity, teaches that a larger and higher collectivity should not absorb lesser and subordinate bodies nor take over the functions which can be performed at a lower level of the social structure. This theme speaks to the intervention of the state to promote the common good and ways in which it should be limited. Subsidiarity was first outlined in Quadragesimo Anno and repeated by Pope John XXIII in Mater et Magistra. "It is a fundamental principle of social philosophy, fixed and unchangeable, that one should not withdraw from individuals and commit to the community what they can accomplish by their own enterprise and industry. So to, it is an injustice and, at the same time, a grave evil and a disturbance of right order to transfer to the larger and higher collectivity functions which can be performed and provided for by lesser and subordinate bodies." (No. 53.) This theme moderates the first. In combination they emphasize government has a role to promote the common good but that it should not diminish individual and local initiative.

A third theme, the dignity of human work. This theme stems from the stories of creation through which we believe that God created all things and all individuals. They are good, and He holds the humans as each being very precious and deserving of basic dignity. Humans are also charged with the management of creation. John Paul II in his Encyclical Laborem Exercens states, "Toil is something that is universally known for it is universally experienced...and yet, in spite of all this toil, perhaps in a sense because of it, work is a good thing for man. It is not only good in a sense that it is useful or something to enjoy - it is also good as being something worthy. That is to say, something that corresponds to man's dignity, that expresses this dignity and increases it. If one wishes to define more clearly the ethical meaning of work, it is this truth that one must particularly keep in mind. Work is a good thing for man - a good thing for his humanity, because through work man not only transforms nature adapting it to his own needs, but he also achieves fulfillment as a human being and indeed, in a sense, becomes more a human being." Later in Laborem Exercens John Paul II speaks directly to the dignity of agricultural work, "This is a vast sector of work on our planet. A sector not restricted to one or other continent. Not limited to the societies which have already attained a certain level of development and progress. The world of agriculture which provides society with the goods it needs for its daily sustenance is of fundamental importance. The conditions of the rural population and of agricultural work vary from place to place and the social position of agricultural workers differs from country to country. This depends not only on the level of development of agricultural technology but also, and perhaps more, on the recognition of the just rights of agricultural workers." And, on the level of awareness regarding the social ethics of work....Pope John Paul states, "But even in economically developed countries where scientific research, technological achievements, and state policy have brought agriculture to a very advanced level - the right to work can be infringed when the farm workers are denied the possibility of sharing in decisions concerning their services, or when they are denied the right to free association with a view to their just advancement, socially, culturally, and economically. In many situations, radical and urgent changes are therefore needed in order to restore to agriculture and to rural people their just value as a basis for a healthy economy within the social community's development as a whole. Thus, it is necessary to proclaim and promote the dignity of work, of all work, but especially of agricultural work in which man so eloquently subdues the earth he has received as a gift from God and affirms his dominion in the visible world." In the chapter entitled, "The Priority of Labor," in the Encyclical Laborem Exercens, Pope John Paul II states. "This truth which is part of the abiding heritage of the Church's teaching must always be emphasized with reference to the question of the labor system with regard to the whole socioeconomic system. We must emphasize and give prominence to the primacy of man in the production process - the primacy of man over things. Everything contained in the concept of capital in the strict sense is only a collection of things. Man, as a subject of work and independent of the work he does, man alone is a person. This truth has important and decisive consequences."

A fourth significant theme - distributive justice is an essential ingredient to our consideration of a just tax structure. In 1956, Pope Pius XII in his address to the members of the International Association for Financial and Fiscal Law, stated, "There can be no doubt that every citizen has the obligation to bear a part of public expenditures. The state, however, on its part, since it has responsibility to protect and promote the common good of the citizens, has the obligation to assess citizens only the levies that are necessary and in proportion to their ability to pay....it is essential, that the moral principles justifying taxes are clearly apparent both to governments and those governed and that they be effectively applied." In Mater et Magistra, Pope John XXIII stated, "As regards taxation, assessment according to ability to pay is fundamental to a just and equitable system."

Given these underlying themes, there are certain basic principles which emerge when the themes are applied to questions of ethics, fairness, and justice in taxation.

## PRINCIPLES OF JUST TAXATION

1. Distributive justice calls for progressive taxation and assessment according to ability to pay. This concern for fairness can be summarized as follows: All things being equal, taxpayers with the same amounts of wealth or income should pay the same amount of tax and those with larger amounts should pay a proportionately greater tax than those with lesser amounts.

2. The consumption of luxuries should be taxed rather than, or at least more heavily than, necessities. The primary responsibility of the economy is to insure the production of a sufficient supply of basic goods and services for all at an affordable price. For example, sales taxes on food and clothing should be at a much lower rate than sales taxes on alcohol, tobacco, jewelry, etc.

3. Government should insure that tax exemptions, tax credits or tax relief promote the common good and not special interests. Taxes should never become a convenient tool used by public authorities to favor one industry or business sector at the expense of another. The government has an obligation to enforce its tax laws uniformally and to collect the revenue which is due.

4. Taxes should be only as complex as is necessary to secure justice. The tax system should be as simple as possible so that taxpayers can understand both the tax policy itself and its administration. Tax policies which require specialized information and talent favor those who are already privileged and adds to existing inequities. Only those who can afford expert advice can benefit by those policies.

5. Taxes must not be excessive. Taxation is excessive if it takes more private income than is necessary for legitimate governmental purposes, or, if it overburdens the general economy. The government should weigh claims of excessive taxation carefully and it must test all private interests against a conception of both basic human rights and a vision of the public good. The government should maintain a healthy skepticism of appeals to interest rather than to principle.

## INJUSTICES IN AGRICULTURE

In applying the principles and themes to current U.S. tax policy, it becomes apparent that there are clear injustices in agriculture that must be identified and addressed. (Church teaching as summarized in Strangers and Guests: Toward Community in the Heartland.)

1. Absentee ownership of the land. Current tax policies provide very attractive tax shelters to those who have substantial off-farm income. Therefore, the agricultural resources are increasingly being held by non-farmers. This is in contrast with the teaching of the Church that holds that the land's workers should be able to become the land's owners.

2. Concentration of resource ownership. Because the tax policy provides decided advantages to those who are in high income tax brackets, those individuals have a decided advantage in owning more and more of the land resources. The results are in contrast to the teachings of the Church that the land's benefits are for everyone and that the land should be distributed equitably.

3. A more capital intensive and less labor intensive agricultural system. Current tax policy provides significant incentives to invest in technology and labor saving devices. The result is that American agriculture is the most labor efficient agricultural system in the world. It is not the most capital efficient or energy efficient. Tax policy provides a disincentive to invest in labor because there are various payroll taxes for which the employer is liable. This injustice is in contradiction to the Church's teaching regarding the priority of labor and the concept that the land should provide a moderate livelihood.

4. Short-range values given higher priority than long-range values. Current tax policies provide incentives for investments which are depreciated rapidly thus promoting further similar investments. Tax policy also encourages maximum cash return from land resources and maximum production each year. These values leave little room for conservation of the precious gifts of soil

and water and they are in violation of the teaching of the Church that people are God's stewards on the land; that the land should be conserved and restored; that "land use planning" must consider social and environmental impacts; and, that "land use should be appropriate to land quality.

5. Land transfer decisions postponed until death. Current estate tax policy provides disincentives for transfer of the land resource during one's lifetime. When these decisions are left to be settled at death, not nearly as much concern is given to making sure the land is transferred to someone who actually will farm and make their livelihood from farming the land. Instead, it becomes just another asset of value that is distributed to heirs.

## SPECIFIC APPLICATION OF TAX PROVISIONS AND RECOMMENDATIONS

Taxation is used not only to raise revenues but also to foster certain social and economic welfare objectives believed to be necessary for the well-being singled out by the tax laws for preferential tax treatment. Special tax rules were developed in the early days to assist farmers with the difficulty of accounting. Over the years other tax features have been added which were designed to help farmers to be able to develop capital assets and to insure the viability of family farms. There are now many serious questions about the true affect of these provisions as they are presently applied to the agricultural structure.

### CASH ACCOUNTING

Different from the accrual accounting system required of most businesses, cash accounting allows for a "mismatching" of expenses and income for tax purposes. By carefully timing sales and the payment of expenses, persons with farm income may deduct expenses in a year when they will reduce taxable income the most and count income in a year when it will raise taxes the least. The affect of cash accounting is that it distorts the progressivity of the tax system allowing farmers and farm investors to create artificial or "paper"tax losses to offset their tax liability. Tax advantages are highest for those in the highest tax brackets and those with the largest amount of off-farm income. The tax system has no provision for distinguishing between those who are legitimate farmers and those who are merely farm investors for accounting purposes. Although cash accounting is intended for farmers, it can be used by any person with some farm income. The distinction between farmers and non-farmers becomes increasingly cloudy as more farmers depend on off-farm income and vice versa. <u>We recommend this privilege be</u>

eliminated. Most farmers have adopted modern accounting and inventory practices. Income averaging provisions should suffice to level taxation resulting from extreme year-to-year swings in income.

## INTEREST INVESTMENT DEDUCTION

The interest investment deduction allows a deduction of all interest incurred on capital investments as a business expense. The amount of deductible interest is directly proportional to the farmers marginal tax rate. For example, a person who has taxable income of $2,500 does not have a tax liability and therefore does not benefit from the interest deduction from income taxes. A person with a taxable income of $25,000 will have a marginal tax rate of 26% thus a 15% interest rate is reduced in actual cost to 11.1%. An individual with a taxable income of $250,000 is in a 50% marginal tax bracket reducing the 15% interest cost to 7.5%. Two points are particularly important here, first, the effective loan rate or interest costs of investment are substantially lower for high income tax payers than they are for lower income tax payers. Secondly, there is no upper limit to the amount which farmers or non-farm investors can deduct for interest expense for agricultural investments. The highest tax bracket taxpayer pays 50% less for interest than the 0% bracket taxpayer. This essentially amounts to a regressive tax or negative tax. We recommend the unlimited deduction of interest as a farm business expense be restricted to farmers active in the day-to-day operation of their farms.

## RAPID DEPRECIATION

This provision of the tax code allows investors in farm equipment to increase the annual depreciation allowance for capital assets rather than amortizing the value of the asset over its approximate useful life. Since the asset continues to be productive without further depreciation, the rapid depreciation allowance is a tax deferral. The benefits of this rapid depreciation are greater for those in higher tax brackets because the reduction in taxes is directly proportional to the marginal tax rate. Tax payments will resume once the depreciation allowances have been exhausted. This system provides an incentive for additional capital investments in order to extend the tax deferrals. We recommend repeal of accelerated depreciation provisions. Depreciation schedules for capital assets should approximate the actual decline in value over the full useful life of each asset.

## CAPITAL ASSET DEVELOPMENT COSTS

Such investments as the costs of developing orchards, vineyards, and breeding draft or dairy livestock, may be deducted in their entirety at the time in which the expenses are incurred rather than having the costs amortized over a useful life. This provision mismatches the expenses and incomes for a given year thus distorting the progressivity of the tax structure by allowing excessive deductions from taxable income. The deductions tend to be regressive since large farmers have higher tax rates. Each dollar deducted reduces the tax burden to a greater extent than for small farmers. We recommend all expenditures to develop capital assets or to increase their value should be capitalized and depreciated, if applicable, over their useful life.

## LONG-TERM CAPITAL GAINS INCOME TAXATION

The benefits from capital gains income are greatest for those capital assets whose development costs are fully deductible at the marginal rate. These include assets such as orchards, vineyards, breeding draft and dairy stock. While costs are fully deductible, sales are taxed at only 40% of the marginal tax rate. Capital gains taxes provide an incentive for speculation and overproduction. The economic benefit of capital gains taxation is substantially greater for high income farmers than for lower income farmers. It encourages expansion of acreage holdings and contributes to the use of agricultural land as a tax shelter. Several factors make agricultural land an attractive investment:

1) Land tends to appreciate in real value relative to inflation but the increase in value is not taxed until the land is sold.

2) Only 40% of the gross profits from the sale of land are taxed.

3) Interest and property tax costs of owning land are deductible on an annual basis.

We recommend 50% of capital gains income be taxed rather than 40%. We further recommend the amount any one individual is allowed to have taxed as capital gains rather than ordinary income be limited each year with a one time exemption available in the event of the sale of a farm, business, home, etc.

## INVESTMENT TAX CREDIT

The investment tax credit is an after-tax credit which may be used to reduce the tax liability. Those who have purchased industrial farm equipment, specialized structures such as farrowing pens, grain bins, dairy barns, etc. or breeding stock, are eligible for a credit worth 10% of the value of the asset. Because the credit is given after the tax bill has been computed, all eligible taxpayers are treated equally. However, the credit discriminates against nontaxpayers who cannot afford to make capital investments or who have no tax liability. The net affect of the investment tax credit and the rapid depreciation provisions provide incentives for continued investment in capital intensive technologies while other laws affecting labor provide disincentives for investment in labor. The combination is a tax system which supports the substitution of capital for labor. We recommend a $2,000 tax credit ceiling in any one year thus .pa limiting the annual tax credit to qualified purchases up to $20,000. We also recommend the credit be allowed to bonafide sales between parents and children.

## INCENTIVES TO INCORPORATE

One of the primary incentives for incorporation is to reduce federal tax liability. The corporate rate schedule is comparatively flatter and less progressive than are the rates for individual taxpayers. The corporate tax rate has been adjusted downward twice in the last decade. Taxes as a percentage of real income increased for sole proprietorships and partnerships. Corporate tax rates begin at 17% for the first dollar of taxable income and increase slowly up to 46% for all income over $200,000. Individual tax rates begin at the lower rate of 11% for income above $3,400 and increase rather rapidly to a rate of 50% for all income above $109,400. For taxpayers having taxable incomes in excess of $16,000, the corporate tax benefits increase as income increases. Corporate tax laws also provide incentives to expand to avoid the penalty of double taxation and to avoid the penalty of excessive accummulation of corporate earnings. Thus, the corporation is continually having reasons to purchase assets which qualify for the capital gains tax and other tax credits and deductions. We recommend that incorporated farming operations be taxed in the same manner as partnerships.

## ESTATE TAX PROVISIONS

The estate tax laws have been liberalized significantly with the 1981 Economic Recovery Tax Act. The unified tax credit has been increased so that by the year 1987, it will allow heirs to receive tax-free up to $600,000 worth of the decedent's estate. Where a couple has divided their assets into two estates, the credit will allow the transfer of up to $1.2 million worth of estate. Therefore, with adequate planning, by 1987, the estate taxes will be eliminated for all but the very largest farms. Special use valuation of land provides the opportunity to value farm land at less than the market value for estate tax purposes. This provision has the effect of making it possible to transfer more land to heirs without tax thus encouraging the acquisition and retention of land and concentration of its ownership. A third provision, the installment tax payment schedule makes it possible for heirs to pay estate taxes on an installment basis over a 15 year period at 4% interest. Since this provision is only used by those who receive estates that are in excess of the unified tax credits, it benefits those who are receiving significant inheritances and it allows them a large reduction in interest costs. We recommend the unified estate gift tax credit be frozen at the 1985 level (equivalent to the tax on a $400,000 estate). The special use valuation for farm estates should be eliminated. Extended payment contracts for estate taxes should carry the interest rate which reflects the current cost to the government for providing the contract.

## INCENTIVES TO TRANSFER FARMLAND TO BEGINNING FARMERS

Several states have successfully instituted tax incentives for retiring farmers to make land transfer decisions during their lifetime and to choose beginning farmers when selling or leasing land. Unlike the previously mentioned tax incentives which are designed to assist people in accummulating and retaining property, these programs encourage divesting one's property and providing opportunity for those who would otherwise not have opportunities. When applied to "private treaty" or "contract-for-deed" sales, these incentives provide an opportunity to farm for the beginning farm family and retirement income for the retiring farm family. This is desirable as it eliminates the need for large amounts of outside capital for the beginning farmer and it keeps the interest of the retiring farmer in the community. The state of North Dakota has had a program such as described here since 1979. Experiences there and in other states can be applied very effectively to federal tax laws.

## CONCLUSION

We live in a time when many of the people who own the moderately-sized family operated farms experience great anxiety and often despair. Many studies show this type of farm operation provides the most effective and efficient production of food and the best stewardship of the land and water resources. Yet public policies are rapidly eliminating them from our economic scene. These families hear politicians and others praise them for their great productivity and efficiency and yet farmers must feel that the praise and the compliments are meaningless, empty words of indifference spoken to a dying breed.

Today, the great economic hope that is being promoted throughout our country, almost hysterically, is "the computer" - high tech. It is almost as though Marie Antoinette were here today not to say, "let them eat cake," but "let them chew silicon chips." The elegant computer is today's fancy cake but just as we struggle to learn the meaning of the Biblical message, "Humans shall not live by bread alone," (Matthew 4:4) - we are surprised to remember that though we do not live by bread alone we do, in fact, need bread. The earth and human labor shall have an important part to play in producing that bread.

Fancy, fashionable technology cannot be the hope of the farmer who operates a family-sized farm. Something deeper and more seriously practical is needed.

American family farmers have often affirmed and put into practice the important long-term values of family relations; community with neighbors close at hand and far away; stewardship of the land; just distribution of the fruits of the land; and the value and dignity of human labor. We need a tax policy that can also affirm these things - one that contributes to our fulfillment of the prophecy of Jesus in the Beatitudes, "The gentle shall inherit the land." (Matthew 5:4.)

5/84
by National Catholic Rural Life Tax Reform Committee
Lynn Clancy, Chair
Kathleen White
Walt Grazer
Bernie Evans
Sr. Mary Mark Tacheny
Reverend George Dyer
Reverend Len Kayser

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Senator ABDNOR. Father, in your studies have you found much merit in this newer proposal? Do you think this would be of help to the farmers?

Father KAYSER. I unfortunately have not had time like I'd like to.

Senator ABDNOR. I'd like your views.

Father KAYSER. Looking toward that and all and expecting some of that, the work that has been done in our tax policy statement certainly, I'm sure, will affirm what you're working toward.

Senator ABDNOR. I think the overall tax policy would be a big asset improvement to agriculture and the farmers. I think you'll feel that way with any of the proposals, whether it's one that has come in by Senator Bradley or the one by Congressman Kemp or the Treasury. We don't know which one we'll end up with. We might have an even different one, as Mr. Durst said, before we get done. I think it might be a step in the right direction, but I am also continuing to look very carefully. As we said in the opening, tax, not necessarily loopholes or exemptions, is seen by some in one way and by others in another. But we need everybody's opinion when this time comes so we can do justice to it.

Father KAYSER. In general of what I know what's going on we certainly affirm. My point again is in the rural crisis thing, this is a major issue and what kind of land tenure we'll end up with 5 years from now or whatever as things are now, this is a major key. I'll submit all this to you.

Senator ABDNOR. Thank you. We'd like to have it.

Our next witness is Dr. William Kessler. Dr. Kessler is from Volga——

Dr. KESSLER. No, Brookings.

Senator ABDNOR. Well, we're not too many miles apart.

## STATEMENT OF WILLIAM KESSLER, D.D.S., BROOKINGS, SD

Dr. KESSLER. I've lived in Brookings for 29 years. I practice dentistry and what I'm speaking for this morning is the investors, because that's what I am, involved in investment capital and how it affects taxes. Of course, what I have given to you is a prepared statement. It is somewhat not on the tax. It is a proposal to obtain capital which is now quite necessary for the operation of the so-called, I call it the entrepreneurial farm, the for profit farm, because I don't think there can be any other kind of farm. In any tax policy that the Congress advocates, I think the first thing we have to remember is that we have to have a for-profit motive if we're going to have a farm operation. Otherwise the only other choice I can see is we're going to have Government controlled farms like we have in the Soviet Union, or we're going to have corporate farms, and I might as well say, being involved with the investor-owned utilities in this country and some 110 of them, and from corporations, we've reached the point where even we're beginning to realize that we've got to reexamine the efficiency of even that operation. So I think the time has come when the Government has just got to reexamine the finances of the farm economy of the Nation. I notice that yesterday the Federal Reserve says that over 50 percent of the farmers have passed the reserve requirements for loans at commercial banks of this district. There was some that said two-thirds, but I made a call to Minneapolis and they said it would be better to say 50 percent. Thus, we are faced with the possibility of wholesale foreclosures without a means to provide continuing operation of agriculture available land to produce food.

We have the talent in the United States to be a profitable entrepreneurial rural economy. We must obtain capital necessary to support this profitable farm operation by avoiding the use of Federal funding except in limited matter. We're always going to have some Federal funding. Capital must come from the private economy utilizing the investment banking of the entire world's private money for investment.

As a matter of review of the historical reasons for the agriculture disaster we now face, we must understand until 1979 the operation of the Federal Reserve monetary policy was somewhat based on interest rates and other financial facts. The appointment of Paul Volcker, a new monetary policy of restriction of money supply was introduced which limited funds available to the economy, including agriculuture. Following an election of President Reagan, an expansive fiscal policy was adopted by utilization of deficit financing. The results of these policies helped create the fiscal problems we now face in agriculture, which are a devaluation of price of land and a reduced purchase of agriculture products overseas because of a stronger dollar resulting in huge surpluses and lower prices.

Since the entrepreneurial farm operation, let's call it for profit farm operation, that's what we want, everyone wants a profit, is by far the most efficient compared to Government controlled farms such as Soviet Union and large corporate farms where managerial controls and administration bureaucracy inherent in the corporate structure stifle innovation and result in greater inefficiency. Thus, the only anwer is, we must find a new method to obtain capital for the entrepreneurial farm. The answer during the present credit crunch in our commercial banking system will be to organize investment farm partnerships with entrepreneurial farm operation being the general partner and the investor being the limited partner. Such investment banks as Merrill Lynch, Dean Witter, Paine Webber, and I spoke to the vice presidents of all these yesterday, would be responsible for obtaining capital while utilizing the ASCS, FHA, PCA, and Federal Land Bank offices to handle actual loans to the entrepreneurial farm. Thus, administrative costs are kept to a minimum. In order to entice pension funds into such partnerships of this type, the Federal Government through Congress must consider the possibility of Federal guarantee of partnerships in the range of 10 to 20 percent. It should be noted that the fastest growth of private capital today is by the pension funds. Of course, such guarantees by the Federal Government should be researched before being added to this capital formation program.

The time has come when Congress must establish a working relationship between private capital markets of the world and the existing Federal agriculture agencies for lending and service to the farmer to provide the needed capital to preserve our entrepreneurial farm.

How does this relate to the tax laws? I think we're going to have to take a long look at partnerships. Of course, this is one thing that your committee and the Treasury Department is advocating eliminating all tax advantages to the limited partnership. I feel in view of obtaining capital, especially venture capital, if we're going to start out young farmers, it's going to have to come from some type of venture capital. Being an investor and knowing thousands of them throughout the United States and involved in one of the biggest industries in the country, the investor-owned utility industry, you have to give some kind of tax—as I said, there has to be some kind of advantage for somebody to put the funds into the new young farmer. In other words, this is——

Senator ABDNOR. That way you're coming with this Federal guarantee?

Dr. KESSLER. That is just a research. What I'm talking about is on your tax laws, right now you have tax shelter writeoffs. That's fine and well. Of course we're going to have to eliminate them. To completely eliminate, I'm wondering where you're going to get your venture capital to start out your new young farmer.

Senator ABDNOR. They've been there and haven't helped much.

Dr. KESSLER. That's why we have to change this. In other words, I'm advocating in our general partnerships, that we go in partnership with the Government to administer these funds for venture capital. This is a whole new idea. It's a new vehicle. It was suggested by Merrill Lynch about 2 years ago and kind of died, because at that time they made a mistake and they wanted to do it all on their own. If we eliminate all tax shelters, this available venture capital for the new young farmer, and if we do want to keep the profitable farm system, we have to have venture capital. We have to give the investor some type of incentive to put his money there, because there's a question whether he's going to receive his return on his investment.

Senator ABDNOR. Didn't I see where it utilized the FmHA under that? Who would be the beneficiary of having access to this, the outside people?

Dr. KESSLER. No, that would be the farmer, the entrepreneurial farmer. This is a whole new idea. It's been pushed around. Yesterday I talked to the vice presidents of Merrill Lynch. By the way, they will be contacting you in Washington. They are quite concerned with the fact that we are now in a situation where commercial banks have a very limited supply of money. The Federal Reserve has certainly limited the supply of money to these banks. If we're going to have capital and survival—in other words, our for profit farms as we have now, we'll have to have a source of capital. If we're to bring the new young farmer in, we have to have some type of venture capital. You have to award these investors, if there's a question of whether they're going to receive a rate of return. What I'm trying to point out is if we eliminate all venture capital, we're going to eliminate the so-called entrepreneurial farm.

Senator ABDNOR. I hope we haven't come that far, honestly. We have quite a percentage of farmers in great trouble we're trying to help out.

Dr. KESSLER. The largest source of money right now is in the private sector, in the pension systems, and in the private investors, and if we can tap this source and bring it over to agriculture, we're not changing the system any. In other words, you're still your farm operator. If he can't obtain capital, which is the situation right now, there is no way he can continue operation. So what I'm advocating is that we take a long look before we close all the shelters, and that we reexamine how they are projected and controlled by the Federal Government, but we still allow money to be put into venture capital so that we can continue to bring in the—it's just like a new business. A farm operation is a business, and we must remember that. We want him to be profitable. We're going to have so many failures which we've always had. The commercial banks are to the point where the only thing they can do is look for—there is no money. All they can do is foreclose.

Senator ABDNOR. You're not telling me now that what we're doing is all right and we just made more of it, are you?

Dr. KESSLER. No.

Senator ABDNOR. You're not saying what I was trying to hit on here, it hasn't been a problem and that may have been contributing to it. Seventy percent or less of the farmers in this country get few of the programs we have.

Dr. KESSLER. We cannot continue that with the continued deficits we have. We have to swing over to the private economy for source of funds. Certainly we're going to have a much more efficient operation if we have a for-profit farm operation.

Senator ABDNOR. A young guy getting started——

Dr. KESSLER. He has to have venture capital. It has got to come through some type of advantage to the investor so that he has a chance to either write it off the taxes or to have a profit off that venture capital or he's not going to put it into that.

Senator ABDNOR. Mr. Durst, where are you, Ron? Would you care to comment? In your experience do we have limited partnerships in agriculture to any great degree?

Dr. KESSLER. They're just beginning.

Senator ABDNOR. Was there some of this in the sixties and seventies?

Mr. DURST. Limited partnerships have been in cattle feeding for many years.

Dr. KESSLER. It's not anything new. I feel it is now a source of capital that is going to be an advantage to retaining the so-called for-profit farming as we seem to want to retain out here. Certainly large corporational farming has many problems, and it certainly is not cost efficient. If we're going to keep it cost efficient, we have to come up with some capital or we're not going to keep these farmers on the farm. As far as taxation goes, I think, Senator, you have to examine your tax program for venture capital before you eliminate it. That's the only problem that bothers me about the Treasury proposal. They have forgotten about venture capital. Does that answer your question?

Senator ABDNOR. My point was, that back in the end of the sixties and seventies, the IRS disallowed that, didn't they?

Mr. DURST. They have tried to, in terms of farm syndicates, they have tried to limit the amount of losses and changed the rules.

Senator ABDNOR. I've heard so much about these in Congress. Everytime we consider something that will be great for business, we still lose and go in the red.

Dr. KESSLER. I'm not asking for restrictions. I think you have to have restrictions. You certainly have to limit out the amount of capital you'll give to venture capital for the young farmer. I just don't want us to cut this completely off. That's what I'm asking for you to consider. Being in the investment field, I think this could be a disaster to the farmer. I think the only source of capital, as I say, right now that I feel can help tide us out in the next few years is out there in the private capital market. It certainly is an answer to deficits, financing. It's an answer to preserving the so-called, you want to call it the family farm, I called it the for-profit farm because I think it has to be profitable.

Senator ABDNOR. Several months ago there was a proposal in the news that holding companies were coming in and offering to buy out a farmer and lease it back to them. That was their idea of it, too.

Dr. KESSLER. That's why I've advocated here the farmer being the general partner. He would still control the operation. The limited partner would put up the funds. The investment banking houses would provide obtaining those funds to the general partner.

Senator ABDNOR. You have to believe the one putting up the funds is going to have input in running that farm.

Dr. KESSLER. Yes; he either has to have a tax writeoff, if he's going into venture capital, or he has to have a return on his investment if he's into a long-term operation.

Senator ABDNOR. We're here to gather ideas.

Dr. KESSLER. I realize this is somewhat new. I have given you some references there for source material, one or two, I'm sure your committee can examine. I believe we are now moving toward a market for-profit system in this country. Obtaining funds from the investor will be very important. In regards to taxation, I want you to be very careful that you don't cut off venture capital in our tax policy. Thank you.

[The prepared statement of Dr. Kessler follows:]

## PREPARED STATEMENT OF WILLIAM KESSLER, D.D.S.

*A New Method for Capital Formation for the Entrepreneurial Farm*

The time has come in the United States when the Government must re-examine the methods to finance the farm economy of the Nation since now in the Upper Midwest according to a release by the Federal Reserve Bank in Minneapolis that over 50% of the farmers have passed the reserve requirements for loans at the Commercial Banks of this District. Thus, we are faced with the possibility of wholesale foreclosures without a means to provide for continued operation of our agriculture available land to produce food.

We have the talent in the United States to have profitable Entrepreneurial Farm Economy, but must obtain the Capital necessary to support this profitable farm operation by avoiding use of Federal Funding except in a very limited manner. Captial must come from the private economy utilizing the investment banking of the entire world's available private money for investment.

As a matter of review of the historical reason for the agriculture financial disaster we now face we must understand that until 1979 the operation of the Federal Reserve Monetary Policy was based somewhat on interest rates and other financial facts. With the appointment of Paul Volcker a new monetary policy of restriction of the money supply was introduced which limited funds available to the economy including agriculture. Following the election of President Reagan and expansive fiscal policy was adopted by utilization of deficit financing. The results of these policies helped create the fiscal problems we now face in agriculture which are a devalution of the price of land and a reduced purchase of agriculture products overseas because of a stronger dollar resulting in huge surpluses and low prices.

Since the Entrepreneur Farm Operation is by far the most efficient compared to Government Control Farms such as the Soviet Union and large Corporational Farms where managerial controls and administrative bureaucracy inherent in the corporate structure stifle innovation and result in greater inefficiency, therefore, we must find a new method to obtain Capital for the Entrepreneurial Farm. Thus, the answer during the present credit crunch in our Commercial Banking system will be to organize investment farm partnerships with the Entrepreneur Farm Operation being the General Partner and the Investor begin the Limited Partner. Such investment banks as Merrill Lynch, Dean Witter, Pain Webber Inc., will be responsible for obtaining Capital while utilizing the ASC, FmHA, PCA and Federal Land Bank offices to handle the actual loans to the Entrepreneurial Farm. Thus, administrati [illegible]

In order to entice pension funds into such partnerships of this type, the Federal Government through Congress must consider the possibility of a Federal Guarantee of such partnerships in the range of 10% to 20%. It should be noted that the fastest growth of private capital today is by the pension funds. Of course such quarantees by the Federal Government should be researched before added to this Capital Formation Program.

Thus, the time has come when Congress must establish a working relationship between the private capital markets of the World and the existing Federal Agriculture Agencies for Lending and Service to the Farmer to provide the needed Capital to preserve the Entrepreneurial Farm.

1. Gifford Pinchot III, Intrapreneuring Harper & Row

2. How The Farm Credit Crisis Is Crushing America's Breadbasket, Business Week, # 2881, February 18, 1985, page 124.

presented to Committee Hearing
U.S Senator Jim Abdnor
vice chairman, Joint
Economic Committee

Copies to Tom Daschole
U.S. Representative

Larry Pressler
U.S. Senator

Senator ABDNOR. Thank you very much.

Do I have anyone at this time wishing to testify? Mr. Daniel, we're happy to have you. The next witness is William Daniel, South Dakota Livestock Association.

## STATEMENT OF WILLIAM DANIEL, REPRESENTATIVE, SOUTH DAKOTA LIVESTOCK ASSOCIATION

Mr. DANIEL. I'm sorry I wasn't prepared earlier, but I do have a few things I would like to address our concerns as livestock feeders are concerned. We do, Senator Abdnor, appreciate this opportunity to be heard, and we certainly are in support of your efforts to limit tax loss deductions in agriculture. We have a resolution to that effect and we are certainly in support of you.

There's been enough testimony this morning in support of that, so I don't think I need to go into anymore testimony in that area. We certainly do support you in your efforts to get this recordkeeping on our mileage eliminated on our farm trucks. We certainly want to be on record in support of your efforts in that area.

There is one area that hasn't been addressed this morning, and it does concern agriculture across the country, and that's the imputed interest provisions in our Tax Code which have been in effect since 1964. We feel that is important to protect the seller, finance transactions in order to preserve and sustain more stability in the farm and ranch land market. When credit becomes increasingly more difficult to obtain to finance land transactions, seller financing provides a very attractive alternative to the parties involved. Without this type of financing, buyers will have to seek out other types of financing if it's available, and it will probably be at a much higher interest rate than what it would be under the present situation. As you all know, the revision of the 1984 tax revision I think brought it up to imputed interest was going to be 13 percent if you charge less, and then the Dole amendment reduced that and that's in effect until July 1 at which time Congress has been instructed to make other arrangements.

Senator ABDNOR. I've been trying to introduce that. I hope we can make it permanent. We had a awful time in getting that in the closing days of Dole. We're in agreement with you.

Mr. DANIEL. I'd like to give you some for instances in that area. If my neighbor is looking for an opportunity to sell land, it's much more attractive to him if he can afford to finance it himself to sell it to his neighbor who can't get other financing, and if he can carry the contract and sell it at a reduced interest rate, it is certainly to his advantage.

Senator ABDNOR. Let me ask you so everybody understands what we're talking about. I was particularly concerned in the case when the father was trying to turn the farm over to his son, he ought to be able to pick his own interest rates. IRS says you have to charge the going interest rates. That's where we got into this disagreement. As they look at it, maybe Ron will tell me, there might be some abuses of it. Some fellow may be trying to get a quarter more than the asking price, because he can deduct it off his capital gain and that makes it worthwhile for him to take the lesser interest rate. The Treasury sees it as a way they are losing dollars. Isn't that right?

Mr. DURST. That's the reason the provision was put in effect, it was being abused in that manner. In large transactions, that can mean quite a loss to the Treasury.

Senator ABDNOR. My main concern is for people trying to sell their home or the business to a family member. I think that's pretty much a family affair, the IRS tells me that the problem is abuse. They look at it as an abuse. I don't know, everybody has their own thoughts on it. It's a way for someone to glean a greater profit by using the advantage of capital gain. Of course, that's one of the things that may be corrected by a new tax proposal. Please tell me how you see that relating to the problem one way or the other.

Mr. DANIEL. I was going to add a for instance and you've covered it partially there. It isn't much of a for instance, because it's an actuality. When I wanted to sell part of my farm business to my sons, we're now in partnership, I could give that to them tax free, a chunk at a time. I couldn't afford to do that. Yet I couldn't, you can't afford to sell your land to somebody who's starting from nothing and pay the interest rates that you have to charge according to Government rule. So you're caught in a very difficult situation there. You would like to give your own family some breaks, and yet you can't. We're interested, we aren't interested in the large blocks of money. We're talking about South Dakota agriculture. I'm sure there are limitations that could be built into this. A million or two million dollar transaction. It's those family-type involvements that we're concerned about.

Senator ABDNOR. I am, too. I think it's a crime. We have all these so-called programs, even some programs to supposedly help young people get into small business. It used to be that the FmHA was of help, but now we turn around and destroy the incentive for that. We have one good program where the parents would like to help the son or daughter out and can't do it because we have this imputed interest bill. That's why I've reintroduced it. A part of the bill passed that's in effect until June 1. Does that partially meet your thinking?

Mr. DANIEL. It's a help. It is certainly better than what was in effect. I would like to see for smaller transactions, say a million and under, if they'd throw out that imputed interest entirely and that would be certainly a help in agriculture.

I have one other thing I would like to address here. This is not speaking, from what I understood, for the livestock association. This is speaking for me as an individual. I feel maybe, Senator, your cap on tax loss might be a little low, and I'm saying this as a personal concern. I'm faced with the same situation everybody else is in an operation where there are people in farming operation where there's more than one individual involved. Regardless of what your equity is nowadays, your lending institution is looking for cash-flow. We all realize what our cash-flow is looking like in agriculture. My lender tells me that in order for our operation to cash-flow, one of the partners has to find some outside income. Hopefully that outside income would be more than what the cap is at the end. In my own personal regard I would like to see that cap raised a little bit. I would like you to take that under consideration.

Senator ABDNOR. Thank you. That sounds like a reasonable thought on the subject and one we may have overlooked, definitely one we have to consider. We have to make it acceptable enough to the Congress if we're going to get it passed. Maybe that will be a problem. We thank you very much for appearing here today.

Is there anyone here wishing to—I tell you what, we're right at 12 o'clock. We ought to break for lunch and come back.

Ron, can we get you back up here for a question and answer period? You're an expert in the area of taxes. Maybe we'll take questions from the audience. Mr. Durst, you are quite familiar with the new tax proposal and, I would like to turn to you if some farmer would be interested in knowing how this related to agriculture.

Mr. DURST. In terms of the Treasury proposal, I've looked into that.

Senator ABDNOR. We can get a feel for what we're talking about. At this time anyone that has a question please come forward and propound the question here and we'll see if we can give you any information on your questions. Would anyone like to ask anything?

Mr. JOHNSON. I was a witness earlier, but I guess I'd like to at least comment or maybe get you, Ron, to get your thoughts on the testimony given by Dr. Kessler, I guess his name was, the investor here. If it is the premise that perhaps we need to reduce the deficit to bring interest rates down and to help the American farmer and help weaken the dollar and help the exports, if we're going to continue tax policies that are going to subsidize investors, aren't we, therefore, going to be increasing the deficits even more, creating further economic hardship for the family farm, and, therefore, continually be unable to pay his debts? I don't know where we're getting off to think we can solve the farm problem by bringing in venture capital or further debt load or outside investment if we're really going to save the American farmer. I think there's pride there in owning his own land. I think to make a peasant or sharecropper out of a farmer is not the concept of the family farm. I would like you, as a member of the USDA, to give your thoughts on that and anybody else. I take exception to his comments. I find them hard to believe.

Mr. DURST. I don't know if I can speak for USDA, but I'll speak for——

Senator ABDNOR. We'll put you on this as yourself.

Mr. DURST. We've had all farm investment in agriculture for several years. One of the reasons is the subsidy from the Tax Code. The investors are looking for that bottom line, that after tax number, and if we're going to continue to subsidize that type of investment, you're going to continue to increase production, reduce that before tax return. A farmer out there who's in a decent situation in terms of his debt load and everything is looking to what he can get for his crop. If you have these outside investors coming in and increasing supplies, they can afford to take a lower return and, in fact, they are investing and getting a lower return in agriculture only because they can get the tax write-offs, and in their after tax return actually is, you know, comparable to something they can get in say another sector of the economy.

Treasury's plan would affect limited partnerships and not allow a lot of the losses to be passed down. We treat them, in effect, as corporations. So that would, indeed, limit a lot of this type of investment. Those losses would not be passed down and would be retained at that partnership level.

I guess the other issue is in terms of some of his comments were in terms of the transition period. We're in a period now where say we have this capital in agriculture and we go to a system where we're no longer subsidizing and through the Tax Code subsidizing that type of investment. We could have, say, an outflow of investment. That might propound the problem if that happens. I think in terms of the current situation in terms of general tax reform and making, basing our decisions on that before tax, that before tax return, what we could receive for our crops and not being subsidized by the tax system in the long run is good. I think again we have to be careful given the current situation in terms of—I think Treasury's proposal in terms of their effective dates and transition periods and phase-ins considers a lot of the problems. Maybe not necessarily in terms of specifically to agriculture, but just in the adjustments that are going to be required overall. I don't know if I answered your question.

Senator ABDNOR. Anyone else? Well, I hate to let you get away without getting some things on the record. Is a Federal tax policy contributing to the decline in the number of medium sized family farms? Do you think it may have contributed to this, and if so, would you try to single out what particular tax laws might be causing this problem?

Mr. DURST. I've seen a lot of discussion in terms of the medium sized and the part time and then the very large. If you look at it in those respects, the medium sized producer is probably the producer principal amount of whose income is going to be from the farm. He'll probably have some off farm income, but very little. Therefore, he's primarily going to be dependent upon the price he can receive from his crops. He's competing with individuals who, a large part of their income may be from off farm sources or from larger operations who can survive. So I think some of our tax provisions, particularly the ones which generate a lot of losses, distort our income picture, certainly have allowed or attracted a lot of additional people into agriculture. These individuals in this medium sized group then have to compete in that same marketplace. Somebody who's operating a farm, he may be, if that's his only income source, it doesn't do him much good to have $100,000 in write-offs, in depreciation deductions, interest deductions if he's getting low product prices. He's competing with others who can use those subsidies from the tax system. So I guess to answer the question, I think it puts the medium sized farmer at a disadvantage.

Senator ABDNOR. Can full-time bona fide farmers compete with big-time farmers who spend more time farming the Tax Code than they do tending to farm operations? Can they survive competition with nonfarmers? We got into that earlier here in the previous question. Any comments on that? That's the very heart of what I was getting at here.

Mr. DURST. Again, that brings up the point he's competing against not only other farmers in terms of their production of crops, but also he's competing in terms of tax benefits, and that's probably where the midsized farmer who depends on farming for his livelihood is at a disadvantage.

Senator ABDNOR. Most of these people if they keep the land long enough, they soon make sure they collect from the Government the support and subsidies. I assume that would be part of the program. Part of it is from the tax law, part from the foolish agriculture regulations. Somebody can establish a wheat allotment on raw land by farming it with all wheat for 2 years, and then end up with the biggest wheat allotment that will lose money. So this person takes advantage of the subsidies or the supports, while the other fellow might have been in business 30 years, some smaller farmer is trying to keep a bona fide farming business and it doesn't work out. That's the kind of things that trouble me more than anything else. Don't you think this is going on today? Don't you think we find big outside interests who are taking full advantage of programs we have in effect?

Mr. DURST. I don't have any data on that. I think in terms of just reading the reports in terms of the PIK payments and the payments under the recent dairy program that a lot of the large farmers are certainly taking advantage of that. That probably raises another question. In some cases our tax policies and our commodity policies and other policies might have conflicting goals. Just as an example, and I don't want to pick on any dairy farmers because my family operates a dairy farm, but we've had the dairy surplus problem. We've had the recent program to reduce production. At the same time we have the accelerated depreciation, write-offs for the dairy facilities and tax credits for investing in those, plus investing in additional dairy animals you get the tax credits and 5-year write-off. Here we have a policy trying to reduce our overproduction problem and also then our tax policies are encouraging. We're sending a signal to expand.

Senator ABDNOR. I might add to that the hog business. We have a lot of new hog confinement buildings going up because of the accelerated, rapid depreciation. It would be different if we needed it, but we have too many already and that doesn't add anything to the agricultural picture but more problems. I'm afraid some of these programs have done these very things. That's what I was thinking when I introduced the legislation I did. A farm program has to be broader than what comes out of the agriculture committee. I think some of the tax provisions which are handled by the Finance Committee and the Ways and Means Committee have to be examined. It's a big picture. It isn't all together in one area where you can attack it.

Mr. DURST. I think it would be good to get some coordination in terms of some of the tax.

Father KAYSER. I'm Father Kayser that testified earlier. I don't want to add to the confusion and I'm sure this isn't going to be a form of the question. My referring there to the story of Joseph and the exception to that was not without significance. I know the legislation cannot guide people's conscience, but I think in all of this discussion, as it's going on here and elsewhere, more and more, somehow or other the church has to be challenged to challenge the conscience of people more than it has done in recent years. More specifically, I've people around calling me, visiting me the last 9 months for sure with various kinds of these investment schemes is all I can call them. They are desperate to hold just an operation for themselves. They have used every tax possibility they can setting up either family corporations or whatever else in the process to try to save it. Yet coming to the conclusion they've got to have some kind of outside capital. So this has been offered in individual cases or collectively even. They know that it can't pay. They haven't been able to make it for 5 years. This will not make it for them either. At least they will be living on their land.

Something has to be challenged in the usury rate of interest in our country. Mr. E. F. Schumacher, a happy memory now, challenged the world some years back about this whole matter of usury. We're talking now in welfare programs and all this which involves agriculture and taxes and all, we hear more and more, that the poor, to regain their dignity when they've lost it, ought to be able to be given the opportunity to work their way out of dependency. To counter that, perhaps the wealthy ought to finally be challenged to work, too. The ones who have, for whatever reasons, gained this investment capital and are sitting in Florida or the North Pole or wherever else and contributing nothing of their talents and gifts to the betterment of society, but are waiting every month or 6 months or whatever their interest payments come in to live off of, and excessive rates, unjust, immoral rates. I'm saying here that that breeds an awful lot of discontent in people who are really struggling. What I'm saying, legislation is not designed, cannot challenge the conscience of the people. I think our Government can challenge the church more than it has to challenge our conscience in these things.

Senator ABDNOR. To finance a $230 billion debt, we have to find somebody that wants to put that money up who will end up with a little advantage instead of a loss if inflation comes down. For instance, if we went back to 13 percent inflation and the lender was only getting 7 percent interest.

Father KAYSER. I think you were challenging Dr. Kessler at that point. More money at that stage is not going to save anybody. If those are the last resort of capital investment for agriculture, then I'm suggesting maybe we can inspire enough people, more motivation for sharing with one another than the dollar sign. I don't want to confuse that, but I needed to state that.

Mr. DURST. Could I make a point? In terms of interest rates, I think a lot of people have looked at one aspect of Treasury's proposal dealing with interest rates, and through much of the seventies we had a period when our interest rates were in terms of comparisons and inflation were relatively low than someone in a high tax bracket because it was deductible. Once he actually claimed that deduction for his interest expense, his after tax cost of borrowing, it was actually negative. By the time you count for the fact he was paying back that dollar in inflated terms, his actual cost was negative. One of Treasury's proposals would factor out inflation as expense and what you would be allowed to do would be to deduct only that portion of the real interest and you wouldn't be able to deduct the interest portion. On the other hand, in order to encourage savings, rather than being taxed on the 13 percent or whatever you're getting for your money, you'd be able to factor out the inflation portion and you're only taxed on the real percentage. They have sort of a $5,000 limit and will allow you to write the full amount plus the home mortgage and some other exemptions, but this would greatly reduce, combine this with the marginal tax reduction, this would greatly reduce the incentive to save. During the seventies the interaction of the inflation and Tax Code really encouraged people to borrow and not save. You stick money in and get 10 or 11 percent and the inflation rate is 11 or 12 percent. You're losing ground.

Senator ABDNOR. I'm afraid that's what happened to our savings and loans. They had those long-term low-interest debts and suddenly they lost more of the other people's money when trying to put away the savings. Because of the inflation they were taken in. Inflation is the one thing I hope we avoid in the future. The indexing does help protect that a little bit. We have two new witnesses who I have asked to testify. Marie Fisher and Lee Swenson. Can we take about a 5-minute break? I'll hold it right to 5 minutes and we'll come back and wind this up.

[A 5-minute recess was taken.]

Senator ABDNOR. The subcommittee will come back to order. Our witnesses I announced as we recessed were both Lee Swenson, president, South Dakota Farmers Union, and Marie Fisher, with Women Involved in Farm Economics. We'll call Marie up here first. Marie is practically a neighbor of mine out in Lyman County, we're happy for you to be here, Marie.

## STATEMENT OF MARIE FISHER, WINNER, SD

Mrs. FISHER. Thank you for letting me testify, although I am testifying on my own behalf. My name is Marie Fisher. I am testifying here on my own behalf, like I mentioned. I am very interested in stopping tax shelter farming because I live just a mile from Winner city limits, and whenever we want to purchase some land, we very often have to compete with Winner businessmen who made their money in their business and then buy land in competition with farmers, making it very difficult for the farmers to obtain enough land to make a decent living. If the farmer did get the land, it was so expensive that it was very hard to pay for it. For instance, I own a quarter of land adjoining the city limits. When we purchased it, a Winner businessman ran the cost of the land up nearly $100 an acre. I certainly don't regret getting the land but it was very hard getting it paid for, and the way conditions are now, a young farmer would not have a chance getting it paid for. We must make it easier for our young farmers to get established in farming.

According to the records in Tripp County courthouse, an undivided half interest in 276 acres joining the city sold for $96,231.50 or $697.33 per acre for an undivided half interest. This sold in 1984. For agriculture purposes, this land would not be worth $348.66 or one-fourth the selling price on today's market.

In Keya Paha County, NE, just across the border from Tripp County, and what Mike Crawley, who recently sold part of his interest in Godfather's Pizza, is paying for land and its effect on the town of Springview, the only town in the county. I spent my childhood near the area and part of the land belonged to my great uncle, Frank Neihaus, so I personally know some of the ranchers affected and the area. Did you want me to give the details of that, too?

Senator ABDNOR. Whatever you care. We could make it part of the record.

Mrs. FISHER. After receiving the letter asking for testimony on tax shelter farming, I called Dale Jahr and told him what I had heard about the Keya Paha County situation. I drove to Springview, NE, on February 4, 1985, to get what information I could.

December 1981, Eldon Schroeder, Newell McCoy, and his mother, Blanche McCoy sold a portion of the Willard Schroeder ranch consisting of 4,477.9 acres to Mike Crawley. December 1983, Michael M. Crawley and Joyce Crawley purchased the Weston Ranch, Inc., consisting of 5,642.53 acres of which 106 acres are irrigated for $1,649,968.80. The appraised value is $510,175. In 1984, Mr. Crawley purchased the Dwain Wicker land consisting of 240 acres, appraised value $20,615 for $60,000. In 1984 he also purchased, by contract, the John R. Demarr land consisting of 880 acres, appraised value $78,140, for $184,800 and 9 percent interest.

Mike Crawley has also purchased some other land, which is not recorded in the courthouse yet, bringing his total purchase to about 16,000 acres or nearly 25 sections or over two-thirds of the township to date. I might add, I have since made telephone calls and confirmed that he has bought this much land and maybe even more. He is paying on the land, where I could find out the price, about triple the appraised value. Nebraska appraises their land at full value, according to the productivity of the land, as determined by the soils map.

Mike Crawley has sued Keya Paha County claiming his taxes are too high. This is an added expense to the other taxpayers in the county. Other ranchers in the county are worried their taxes will be raised because of the price he is paying for the land he is buying.

After I got the information in the courthouse, I went to the business places in town and asked them if they had been hurt yet by the loss of the ranchers. Most of them said that they had been hurt some and some others said they had not been hurt yet, but they expect to be shortly, when Mr. Crawley gets better organized and buys more items wholesale and does more of his own repairwork. Springview has been growing in recent years, but the attitude in the town now is very depressed.

Senator ABDNOR. Is he breaking up that land for farming?

Mrs. FISHER. No, I don't think so. Of course, nobody knows what his intentions are, but apparently he is going to develop it into a big ranch. He had part interest in Godfather's Pizza, and sold part of his interest that he had in Godfather's Pizza. He still has part of it, I understand.

Senator ABDNOR. We don't know yet whether he would be farming this land. Is it all quite fragile land?

Mrs. FISHER. For the most part, yes. I would hate to see the land broke up. There is not very much farm land in that area. The

Weston Ranch does have a little bit of farm ground in it. The Schroeder ranch they used to farm a little bit. As near as I know, it's been put back to grass or alfalfa. It just would not be that good of farm ground.

Senator ABDNOR. In your area in Nebraska and South Dakota as you go west, is much of that grassland being broken up and put under cultivation?

Mrs. FISHER. Not much in my area. I went to Gregory and then down in Nebraska, so I went across Keya Paha County from the east up to Springview, I didn't see hardly any land there broke up. The weather conditions were too bad. I wanted to go on across to the west. The roads were too bad to go to the west. I know there is some more irrigation in the western part of the State. Like the Weston Ranch has some irrigation on it.

Senator ABDNOR. You've been studying this picture. Have you given any thought to the new possibility of tax reform, in general? We're on both subjects.

Mrs. FISHER. I think the tax reform, this goes to show that tax reform is very urgent for the simple reason, for the price he is paying for this land, there is absolutely no way he could anyway near make a go of it. When I talk to other ranchers in the area there, they are very perturbed he is paying that high cost for that land. There's no way they can compete with him, because they have to make their money off the cattle they raise on that land after while. There's no way they can do it. That's what the ranchers told me I talked to.

Senator ABDNOR. That's what my bill is all about. I guess over and beyond that, do you think this new tax reform proposal, the Treasury one, do you see much benefit in that for farmers?

Mrs. FISHER. From the information I have, yes, but I don't want to say definitely just yet because I can't get enough information yet to answer that specifically. For instance, I can't find out yet what deductions the farmers will be permitted in this new bill. I've heard some rumors that some things will not be deducted as an expense on this new bill. If they're not, then I would really have to question it.

Senator ABDNOR. I'm not out trying to sell it. I'm still reviewing it, too. For those that may be concerned about it, you have to realize, the rates are going to be way lower. There will be greater exemptions, and there will be indexing in other areas to offset it. It's a package you have to really sit down and explain a lot of times. I'm sure there will be some areas that will not be allowed. It's really in a way, one might say, an unwarranted tax exemption. You may think it is. I'm not going to argue that. The question is, Are we going to start closing up some of these exemptions that presently exist throughout our entire tax law? Some of them are, but on the other hand, they do get some breaks in other areas.

Mrs. FISHER. The one that I have a question on that has been brought to my attention is we would not be able to deduct interest. I could hardly believe that would be so.

Senator ABDNOR. Interest on a second home. Ron, go ahead.

Mr. DURST. What Treasury's plan would do would be, the Treasury's plan would, I guess, allow the real portion of the interest deduction, and by the real portion, I mean they would establish a fraction based on the inflation rate and the real cost of money in terms of—generally right now in their example they used in their package, they used 4 percent inflation rate and a 6 percent real cost of money and about 10 percent or so prime rate. Then they would say you would be allowed to deduct only 60 percent of that interest. In their proposal they also exempt, now they exempt home mortgage, the home mortgage, they wouldn't make you index that. They also have a $5,000 sort of base which would not be subject to indexing, as well. So there would be some interest expenses in a case where a farmer has substantial amount of interest expenses, say above that $5,000 cap where he would only be able to deduct, or she would only be able to deduct a portion of that. Again, you have to look in terms of the overall package. Like the Senator said, you may lose some of that, but you'll also gain in terms of the reduced tax rates and increased exemptions. So you have to look at it as an entire package. Also, Treasury has, they provide for transition periods. They may exempt or may take into account current obligations that individuals have. So I don't think the whole thing is completely worked out yet, but there is a transition period which that would take effect. There would be some expansion in terms of the tax base and loss of the deductions, interest deductions.

Mrs. FISHER. Taking it off the top of my head here, I would say that would cut my son's income tax expenses this year between 6 and 7 percent which would be quite substantial.

Senator ABDNOR. You have to realize, that's why we have to weigh the tax exemption we're going to close. We certainly want to hear how people feel about it. Maybe we can improve on it.

Mrs. FISHER. I studied the Treasury's deal and studied two others of, I studied them very thoroughly and compared my son's income for this year with them, and kind of off the top of my head, to give a little thought to it, I think that's about the percentage of his income tax would be deducted then. He had that much less income tax to pay this year.

Senator ABDNOR. Marie, we thank you for coming.

Mrs. FISHER. Thank you.

Senator ABDNOR. We're happy to have Leland Swenson, South Dakota Farmers Union. This guy has been busy. I know all the guys he prepared in getting ready for the big, successful rally yesterday. Congratulations and I commend you for it.

## STATEMENT OF LELAND SWENSON, PRESIDENT, SOUTH DAKOTA FARMERS UNION

Mr. SWENSON. My name is Leland Swenson. I'm currently serving as president of the South Dakota Farmers Union, the State's largest farm organization. My home is Huron, SD.

Before I start the testimony, I want to thank the Senator for participating in the rally yesterday in Pierre, SD, and the statement you offered to those in attendance was tremendous statement on behalf of agriculture and the changes that are needed within the Federal Tax Code to provide equity in the agricultural area.

Senator ABDNOR. Thank you.

Mr. SWENSON. Also, in your statement yesterday in relating to what the State can do, I think really points out that we have a deficiency even within our own State on the type of structure that we need to maintain the family farm system of agriculture, and I appreciate your support.

Senator ABDNOR. If I may add to that, I notice in today's paper some unusual steps on the part of the States. I think Minnesota and Iowa have legislation forthcoming. My point yesterday was that this is everyone's battle, therefore, we may all have to do unusual things to try to go beyond what we may have thought of was a reasonable effort in past years and unnecessary now. It was easier to say what we're going to do from Washington, but there's certain things we can do at the local level.

Mr. SWENSON. The introduction of the specific legislation under discussion here today is genuinely positive development. If passed, the bill would go a long way toward eliminating unfair tax advantages that for too long have benefited nonfarm investors at the expense of the bona fide family farmers and ranchers.

We believe the current situation is especially critical because of the economic crisis now facing agriculture. It's been estimated by reliable sources that hundreds of thousands of American family farmers and ranchers are in jeopardy of being forced off the land. In putting it into a context of the State, a survey of lending institutions said 24 percent of the farmers in South Dakota are under financial stress. You put that into the numbers of the number of farmers we have in this State, that's approximately 9,000 farmers in the State of South Dakota.

At the same time this catastrophe has settled upon rural America, we're faced with an ever increasing onslought by nonfarm investors who are actually entering agriculture with the intention of losing money. They can afford it because Uncle Sam is paying the bill. They are able to write off the farm losses against their Federal tax liability on nonfarm income.

We have reached the point where these tax loss farmers are on the verge of taking over whole segments of agricultural economy. Already the vast holdings in southern cattle feedlots have tended to increase supply and depress prices for genuine farmers and ranchers.

On the State level, if I could insert here at this time, we have a bill in the State legislature to allow corporations to get into feeding of, owning agriculture land for feeding poultry and meat processing and eggs. The interesting thing is that 63 companies now have 52.2 percent of all the layers in the country. The No. 1 is Cargill, Inc., based out of Minneapolis. They have 10 million layers in nine production sites in nine States. It shows you the influx of off farm investors, corporates, into the control of agriculture.

In Indiana, a State with no anticorporate farming law, the Prudential Insurance Co. has purchased and installed irrigation equipment on extensive holdings. In two counties they've taken over 23,000 acres of land. They have managed to do this to the detriment of their neighbors and with assistance of array of loopholes in the Federal Tax Code. The U.S. taxpayers are paying them to buy that land to put in the irrigation systems and to drain the wells so there's no water for the neighbors.

The Center for Rural Affairs at Walthill, NE, has also documented extensively the growing corporate tax loss operation in the hog markets. In a recent article entitled "The Tax Shelter Undermines the Family Farm and Increases the Deficit," the center notes to compete in the tax shelter industry, one must competitively exploit the Tax Code. High bracket taxpayers with the money to invest in the most capital intensive operations, including corporate and nonfarm investors, benefit the most and thereby gain a competitive advantage. Moderate size farmers, beginning farmers, and farmers struggling to survive benefit least from the tax break and suffer most from lower hog prices.

A 50 percent bracket investor in a 500 sow confinement operation receives nearly 2.5 times the benefit per hog as a typical, established 30 percent bracket family farmer with modern facilities receives over 5 times the benefit as a 20 percent, and received 5 times the benefit as a 20 percent bracket beginning farmer using low-investment systems. This favortism is not justified by efficiency. University of Missouri research has shown that bigger hog operations aren't generally more efficient, and the University of Tennessee research has shown that moderate investment systems are more efficient than tax favored capital intensive system.

The Center for Rural Affairs goes on to estimate that the excess hogs produced by giant nonfarm investors will have a negative impact on price during future years. The estimate is that prices will decline by about $1.20 per hundredweight. In other words, the impact would be a loss of $2,000 to $3,000 per year for a typical family farmer with a hog operation.

Secretary of Agriculture John Block has contended that Federal farm price support programs have tended to distort agricultural markets. It appears to us that if the Secretary really is concerned about market distortion, he ought to join in support of the bill and other efforts to reform the Federal Tax Code.

We believe that passage of Senator Abdnor's bill to limit the amount of farm losses that could be written off against nonfarm income to $20,000 would be an extremely positive step. It would be good news for family farmers and ranchers who have very little good news to cheer about lately. It would also help to reduce the Federal deficit and establish greater equity in the Federal Tax Code. We believe these are meritorious goals and we strongly support the passage of this bill and the closing of other tax loopholes.

Senator Abdnor. Thank you. I'm happy you were able to make it here to the meeting today. Incidently, I had Secretary Block in front of my Joint Economic Committee last week. I got him to tell me this is a good bill. Let's see if we can keep him on our side as we progress. I'm sure I am quoting him right. He said he could support that. We wouldn't have to be breaking up all this land and giving all these incentives to farmers who are not farming for the benefit of the business of farming, and we do find a lot of support for this. I have to admit, we have people who are opposed to it, too. We hope we can attract the Finance Committee to have a final word on this. If I had the Agricultural Committee, I could move it along quicker. Senator Packwood is chairman of that committee and might consider putting in part of the new tax package he probably will be looking at. I just want to say we appreciate your support and hope we can continue to have it as we move forward with this legislation. Actually this bill doesn't go so far as to prevent somebody from coming in and making a go out of farming and making a profit. We don't actually stop him. We'd rather not have him do it, but we should take care of the people farming for the tax law so he can use it for some other benefit.

Mr. SWENSON. If we're concerned about the deficit and tightening up the loopholes, it's not just an agricultural issue. It's an issue of business community, small businesses that are struggling to survive, that loopholes in our current tax law allows corporate business a major upper hand in trying to drive small businesses and locally owned businesses out of existence in our small towns and rural communities, communities such as Sioux Falls, Rapid City, Aberdeen, Huron, and so forth. I really think the issue of tax reform and lowering the national debt is one that should take pretty high priority over that of many other issues that are before Congress. I would sure hope that those Congessmen and Senators that are out advocating that we have to control the deficit and we have to cut spending would look at a way that we could also cut or provide equity among the people of this country. One of the ways they could do it is closing many of the tax loopholes.

Senator ABDNOR. I think that's good. One of the real telling points is that the IRS has told us, that if they forego tax payments from farm income, but by the same token did not allow any tax law farm loss in the way of a tax benefit, the Treasury will be many dollars ahead. They are losing more dollars out than they are taking in. This came from the IRS. We asked for the study one time. If the farm sector neither paid or took deductions, the U.S. Treasury would be better off. Farm net income reported to the IRS in 1981, this is as far as current as they could do, amounted to $8.5 billion. Farm net losses totaled some $16.3 billion. This demonstrated both the poor financial condition of farmers and tax loss farming. I don't think it contributes much to the picture. That kind of farm will soon be benefited by the farm supports that come out of Washington that contributes extra bushels to production we don't even need. We certainly don't need the incentive in that direction. That was certainly one of the real things we were trying to get to. We hope we can continue to pick up support from other farm and State Senators and even Congressmen and keep this thing moving. Lee, I know how busy you've been and the strain you've been under putting this altogether. We appreciate the fact you took the time to come over so we could have your testimony for the record, because this is going back to Washington where we can use it.

Mr. SWENSON. If we're interested in the long term survivability of family farm agriculture, the area of Tax Code is just as good as getting a good farm program. If you take away the equality of operation from now into the future and just provide income, you're still providing the advantages to the off farm investor. If you put profitability out there and don't close some of the incentives for him to come into agriculture, you're providing him the advantage over the farmer and rancher out there trying to survive through generating his own capital and own wealth, and we would sometime just be defeating our own purposes. I do appreciate the opportunity and felt it very important to be here.

Senator ABDNOR. Thank you very much. Is there anyone else that wants to testify?

Mrs. FISHER. Could I make one statement? I would just like to add, I made the statement my son made some money this year. The only reason we made money, and I've been on that place since 1950, we had the best crop we have had as long as I've been on that place. That's the only reason we made money this year. If Block gets his new program in and we don't get a good crop, we'll be really hurting, too. I would like to stress that point because I made the point, kind of going against what we're working at. It's just fortunate we have had a good crop.

Senator ABDNOR. That was a real blessing. Some of the areas in my section of the country have had three good crops. Well, I'm afraid a moment ago there were some people that wanted to testify. I guess they had to leave. With that, I will adjourn the committee meeting and thank everyone who made the effort to come out. We have two things we're concerned with here, how you see the new tax reform affecting you and how you feel about it, and more especially, how we will respond. It is important to hear how you respond to this type of legislation, the tax loss proposal I have. I mentioned earlier, before you were here, Lee, that we're still working on that motor vehicle logging. That has nothing to do with taxes, except the IRS is the one that puts it in effect. We have to have a hearing on my Subcommittee on Appropriations that I chair that has the budget of the IRS. I have some tax experts that I'm not too happy with it, either. I hope we can build enough continued fire under that to get it moving. We are looking forward to legislative delegations coming in. I understand on the 25th or 26th we've been asked by the Nebraska people for a regular hearing with the Joint Economic Committee and Chairman Obey of Wisconsin is extremely happy to have this. We'll be seeing a lot more. I don't know if you're coming in at that time or not or anyone else. That should be an interesting 2 days in Washington when we all come in. Thank you once again for coming out. The subcommittee is adjourned.

[Whereupon, the subcommittee adjourned, subject to the call of the Chair.]

# APPENDIX

National Pork Producers Council Executive Committee
Statement to Delegates on Taxes:

The investment tax credit (ITC) was first used in 1962. Legislation was passed allowing tax credit for investment in specialized hog facilities at the request of the NPPC, in 1978.

Budgeted examples can be developed that show the tax credit tends to increase production of the individual pork producer by lowering production costs and raising after-tax profits. It is not clear, however, that the pork industry as a whole has reacted to the credit by increasing production. Large pork supplies in the period immediately after the 1978 legislation can be explained better by the hog cycle rather than by investment tax credit.

Available information does not support the idea that the ITC has had a large impact upon productive capacity and new investment in the pork industry. It is probable that the tax credit has increased investment, but the effect was not large enough to show up as statistically significant.

It is sometimes argued that the ITC favors hog production in large scale units. Research does not support this argument. If ITC is eliminated, with the rest of the tax code remaining the same, the growth rate of net worth is reduced about the same for large and small farms.

The bias in the investment tax credit is more toward relatively high investment production methods, than it is toward large scale operations. For example, more credit is earned through total confinement hog production than through hogs raised on pasture or in remodeled buildings. Insofar as large scale producers use high investment methods, the tax credit favors large scale operations.

Investment credit earned on hog facilities can be used to offset taxes on both farm and non-farm income. The value of the credit to the taxpayer does not rise as non-farm income increases, because the value of the credit does not depend on the tax bracket. In computer simulations of pork producers with various levels of non-farm income, the elimination of investment credit reduced growth in net worth about the same for all levels of non-farm income. The producer with high off-farm income, which approximates the situation of the non-farm investor, gains slightly more from the credit only because he invests more and earns more tax credits. It should be noted that the producer with off-farm income can have an advantage in cases where taxes on farm income are not large enough to absorb all the tax credits earned.

There has been some concern about the impact of recent changes in tax regulations, particularly rapid depreciation schedules and investment tax credits, on specialized agricultural buildings and equipment used in livestock production. Preliminary indications are that these income tax features provide a slight additional incentive for investment in capital intensive hog production operations, which can slightly increase supply and reduce revenues in the short-run. Other factors contributing to larger size production units are more important. Obviously, larger higher-income producers would benefit more from these tax changes, while low income producers would benefit little.

Terminating those favorable tax features would probably hurt higher income producers in the first three to five years. Pork producers in general may be better off in the long-run if new investment in hog production facilities was not encouraged. Recent tax law changes may accentuate the cyclical problem by giving slightly more incentive to expand when profits are high. However, the overall impact of those tax features was extremely small relative to the impact of the overall change in tax rates for individuals in the tax laws enacted in 1981. And, removing the tax benefits from the pork industry without similar treatment of other livestock and poultry producing industries would, undoubtedly, contribute to a competitive cost disadvantage for pork producers.

If the investment tax credit and the accelerated depreciation deduction are eliminated, some pork producers will lose and some may gain. We have a good idea who will lose and how much. The producer who builds new specialized facilities will lose by the amount of the tax credit and the value of the deduction (the present value of the annual deduction times the marginal tax rate.) The benefits are more general and more uncertain. We don't know that it would cause pork prices to rise. We don't know if it will keep non-farm investors out of hog production, if it is profitable for pork producers without the tax deductions it may also be profitable for them. Proposed revision of the complete federal tax codes will have a greater impact on all individual pork producers than either of these two present provisions. Production efficiency will more directly influence profitability of an operation than present tax provisions.

The number of pork producers has steadily declined during the period of 1950 to 1984. The most rapid rate of reduction in producer numbers occurred during 1950 to 1975, a period when there were no tax incentives. The rate of reduction of pork producer numbers has slowed during the period when there have been tax incentives. Some loss of pork producers has been due to the pork industry becoming less labor intensive and more capital intensive.

Recognizing these factors, it is the consensus of the NPPC Executive Committee that the pork industry should presently maintain a neutral position but monitor forthcoming tax changes and evaluate how these changes may impact the pork producer.

# SOUTH DAKOTA FARM ALLIANCE PROPOSALS

***Immediate Farm Program Needs* (1985 crop year)**

*1. An immediate moratorium on farm and ranch foreclosures.*

*2. Establishment of a program to restructure farm debt at serviceable interest rates.*

*3. A substantial increase in commodity loan levels and target prices. Loan levels should be increased to at least the cost of production with strict limitations placed on the amount of commodities that any one producer could place under loan.*

***Federal Tax Reform***

*1. Reform of the federal tax code is needed to eliminate loopholes and tax shelters that have allowed non-farm investors an unfair advantage compared to bonafide family farmers and ranchers.*

*2. In the event that complete tax reform is not accomplished this year, we support Sen. James Abdnor's bill to place definite limits on the amount of farm and ranch losses that could be used to reduce tax liability on non-farm income.*

***1985 Farm Bill***

*1. The 1985 farm bill should include all agricultural commodities on an equal basis.*

*2. The bill should be based on 100% of parity including, the full cost of production, designed to provide profitability for family farmers and ranchers at a level comparable with other segments of the national economy.*

*3. The new program should be long-term.*

*4. The new farm program should include a strong program of soil and water conservation.*

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* The South Dakota Farm Alliance includes: South Dakota Farmers Union, South Dakota National Farmers Organization and the South Dakota American Agriculture Movement. For additional copies of this proposal, contact: South Dakota Farmers Union, Box 1388, Huron, South Dakota, 57350. Phone: 352-6761.

A FARM -RANCH PROGRAM THAT WILL WORK, Proposed by: Independent Stockgrowers of America, I.S.A. Board Chairman, George Levin, Box 565, Sturgis SD 57785.

The long-time U.S. policy of encouraging abundant food production and using this abundance to influence international affairs has had an adverse effect on the agricultural community. Not in our history has its impact been so devastating as today.

Many thousands of farmers and ranchers have been forced into bankruptcy or are facing that possibility and rural communities are losing businesses as more and more of them take on the characteristics of ghost towns.

The back of agriculture is being broken.

What has been called the "cheap food policy", but more accurately the "low Farm Commodity Price Policy," is the major cause today of farm failure.

The main aspect of this policy is that of using food as a weapon in international affairs, and its long standing bi-partisan support.

In 1974 Agricultural Secretary Earl Butz stated that food is a weapon: "it is one of the principle tools in our negotiating kit."

Orville Freeman sounded a similar theme in 1961. At his swearing in ceremonies, the present Secretary John Block, mentioned using food as a weapon, and indicated that the Administration would continue the policy, as they have.

The Cheap Agricultural Commodity Price Policy is not the only aspect of the farmers predicament. Of great importance is the weak, or no, bargaining position as they strive for their share of the ecnomic pie. On the other side of the table are powerful economic interests, many of them huge monopolies, which dictate the prices farmers pay, and for what farmers are paid for what they have to sell.

The government policy to keep farm commodity prices low, is reflected in the 55% of parity for farm commodities today. In recent years it has been government policy to encourage the growth of monopolies and to permit the weakening of the antitrust laws, which put farmers at an even greater disadvantage. Allowing the ruling by the U.S. Supreme Court in the Illinois Brick case to go unchallanged is a case in point. That ruling, which prevents those who have dealt indirectly with an alleged price fixer from maintaining an antitrust action, had the effect of repealing the antitrust laws as far as the protection of farmers is concerned.

Nor does increased exports, or the lowering of interest rates, provide a meaningful avenue of escape for distressed farmers. Agricultural exports have doubled in the last ten years, yet today many export commoodities are selling below 50 percent of parity. Reducing interest rates, even if it were possible, in this time of huge federal deficits, wouldn't help enough. More and more leading economists are now saying: big improvements in commodity prices are needed to prevent the complete collapse of the farm economy and the financial institutions that serve it. These and other factors combined deprive the farmers of any hope of getting their rightful share in the marketplace. Government policy, as it is structured today, just will not permit it. The small segment of our population, agriculture, is called upon to bear the entire cost of a national policy that is thought, at least by our policy makers, to be in the interest of all, unless the government is willing to intervene in a way to spread the cost to all of society. Dr. Hoops, president of SDSU, alluded to this need when he spoke to cattlemen in Rapid City recently. In his prepared remarks he stated: "farmers and ranchers shouldn't have to bear the entire burden of the nation's cheap food policy."..."If the cheap food policy is to be continued," he said, "it should be spread evenly across the backs of all citizens, rather than one small group."

The 1985 farm bill must have as its main provision a formula that will have the effect of equalizing the costs of national policies. Much presidence has been set in the past in this respect.

We have seen it in the case of Chrysler corporation, and with Penn Central railroad and more recently when $4.52 billion in tax funds went to bail out one Chicago bank. That bank, Continental Illinois, was, in the view of one ag economist, at least, probably guilty of more midmanagement than most farmers.

It can be agreed that it is only fair that all of us should bear the cost of national policy, rather than one small group, then it would be a fairly simple task to write a new farm bill.

I submit the following as a proposal, that, if adopted, would have the effect of spreading the cost of national policy and would revitalize the rural communities and prevent mass foreclosure of independent farmers and ranchers and small town businesses.

Under this proposal the USDA would establish target prices for all agricultural commodities. Under the provisions of the new 1985 farm bill, each producer would be paid the difference between the average market price for the year and the target price. These payments would be on whatever was produced, be it grain or livestock, or livestock products, or cotton or wool or vegetables or fruit etc. (more)

These payments should be limited in a way that would not encourage over expansion in agriculture. They would apply only to a volume of production for each producer that would yeild a net equal to the median income for the nation. The median income is $23,600.

To further refine this proposal to prevent the influx of outside investors bent on taking advantage of the plan, any non-farm income in excess of two/thirds of the median income would be deducted from the incentive payment due under this plan. This may sound complicated, but it need not be. Anyone wishing to claim payments under this plan would have to declare the amount of non-farm income expected for the year. If non-farm is expeected to be less than 2/3 of the median income he would be eligible for full payment. If he expects it to be more he may have to wait until income is added up at the end of the year to have it determined what his payment will be.

The USDA will determine the volume of production to which target prices woulld be applied. Land costs will be treated as an expense along with the normal cost of production expenses in determining that volume. Advantages over the previous bills are:

I.A much smaller bureaucracy would be needed to administer the law. There would be no need for allotments or quotas or price supports thus drastically reducing the work load. Probably one person in a county could handle the paper work. Millions would be saved in administration costs that could go to help finance the program.

2.The market place will determne all prices. This should appeal to those who say they want a market-oriented agriculture. All Americans will be sharing some of the risks of the market place

3.The market place will be free to reflect product quality.

4.Farmers will be paid on only what they produce. Some programs in the past paid farmers not to produce. This has been a sore spot for consumers. No one will be paid unless they produce under this plan. Farmers will be producing for the market.

5.The U.S. would become more competitive in the world markets.

Prices in the market place will no doubt fall making it possible to gain a bigger share of world trade and allow us to end our quarrel with the EEC over export subsidies.

Lower prices would encourage more consumption at home and abroad so that a market could be found for all of our farm production.

6. Broad based support would be assured.
   Consumer, church and labor groups in the past have indicated that they would support farm bills with limits that were targeted at family farmers. They have not had much enthusiasm for previous programs which has seen the government going into the market place and bidding up prices in competition to them. And because they are not saving the small family farms anyway.
7. For the first time a true safety net will be provided for family farmers.
   There is much retoric in Washington these days by politicians going to the point that family-type farmers must be the target for the new farm bill. This proposal does that.
8. Will end the distortion of America's agricultural production pattern.
   Programs in the past have drawn much fragil land into cultivation because there were no programs for livestock. It seems safe to predict that under this plan that practice would cease. It would again become profitable to raise livestock on land that not is not suitable for farming.
9. Conservation of the soil would be greatly enhanced.
10. Compliance would be voluntary.
    Most farmers want voluntary programs. No one would be forced to participate.
11. The automatic phase-out of this plan would occur when parity becomes a reality in the market place.

For free copies of this program to send to Congressmen, or friends, or anybody, plus copies of twin Bills,S 2835 and HR 29, write I.S.A., Box 565, Sturgis SD 57785. The bills are the "Agricultural Producers Protection Act." This law would enable farmers and ranchers to sue price fixers, and collect, be the proven damages either direct of indirect. They have been introduced and need support from the people and Congress.

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